MODERN BANKING IN INDIA

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BY

S. K. MURANJAN, M.A., B.Sc., (LOND.), B.E.S.

PROFESSOR OF BANKING, SYDENHAM COLLEGE OF COMMERCE AND ECONOMICS, BOMBAY.

BOMBAY

NEW BOOK CO.

Kitab Mahal, Hornby Road.

1940

Printed and published by P. Dinshaw at the New Book Co., 188-90, Hornby Road, Bombay.

PREFACE

NO individual bank or banking system could be understood or judged except in the light of its past history. This is specially true in a country like India where banking is still in the earlier phases of its growth and where conditions differ materially from one part to another. The history of banking in India is indeed not much older than a few decades. But, even in that short life history, Indian banking has confronted one serious crisis, lived through the hectic times of the greatest war in history, survived unscathed an unprecedented world depression and stands today on the threshold of another great war. Events of such magnitude cannot but expose a banking system to severe tests and leave indelible marks behind. The present volume is an effort to portray banking in India in the historical and contemporary context of these events and circumstances.

Recent as are the origins of Indian banking, systematic exposition of our banking problems or monographs on origins and growth are more recent still. Among official documents, the Reports of the Herschell Commission, the Fowler Committee and the Babington-Smith Committee are concerned exclusively with our currency problems and make no more than incidental references to banking and credit conditions. The Chamberlain Commission found place for an Annexe in which is presented an interesting scheme for a mixed Central Bank for India somewhat on the lines of the Bank of France. Taking its cue from the prevalent opinion and sentiment in post-war Europe, the Hilton-Young Commission made a departure in placing in the forefront proposals for a Reserve Bank of India and stressing the need for an inquiry into and improvement of ordinary commercial banking. Their suggestions bore fruit in the Reports of Central and Provincial Banking Enquiry Committees which form a voluminous survey of contem-

porary banking conditions with suggestions for improvements.

Among unofficial publications, praise must be accorded to a few monographs on earliest origins of banking in India. The rest consist very largely of expositions of Indian aspirations on the subject unsupported by much study of existing conditions or meticulous synopses of material and ideas contained in well-known but bulky documents.

After the manuscript of the present volume was placed in the hands of publishers, the Reserve Bank of India published and circulated its proposals for a Banking Act. It was neither practicable nor indeed desirable to incorporate the various points raised in the document into the text itself. The proposals are indicated in foot-notes in relevant places with brief comments on their tendency and character. Along with the proposals, the Reserve Bank published also a very interesting memorandum on non-scheduled banks with special reference to distribution of assets and liabilities. The valuable tables on which the memorandum is based are broadly summarised in the text with incidental alterations in conclusions made necessary by these exact figures.

In spite of generous and appreciative compliance from many quarters, much difficulty was experienced in assembling extant material on the subject. Close co-operation and mutual assistance between " academic " and " practical " people, which have so strikingly advanced both interests in nationally minded countries like England, Sweden, etc., are still a mere aspiration in this country. In spite of every endeavour, no one could be more conscious than the author himself of the grave deficiencies and perhaps inaccuracies of the material acquired and used. Readers who invite attention to any faults will establish as great a claim on the gratitude of the writer as that of the public for whom the book is meant.

Sydenham College,
August 1940.

S. K. MURANJAN

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CHAPTER I.

EARLY BEGINNINGS

I. Before 1860

BANKING on modern lines began in this country with the foundation of the Agency Houses of Calcutta and Bombay in the 18th and early 19th centuries.

The Agency Houses were mainly trading concerns interested in tea and indigo. Banking was only an adjunct, although the most important one, to their business. In the course of their banking activities, they issued quite a volume of notes.*

The Company's services were the main recruiting ground of these "merchant princes of India." Many of them were men who abjured the limited prospects of the Company's employment for the incalculable prizes of private trade and commerce. Some drifted into these avocations under less praiseworthy circumstances. The situation changed a little after 1813 when entry of private persons from abroad was permitted under a strict licensing system. Rights of residence and property were conferred on foreigners much later by the Charter Act of 1833.

Although some of the later joint stock banks rose quite independently of Agency Houses, these must be regarded as pioneers of this type of banking enterprise in this country. Since there was no law till 1860 giving legal recognition to limited liability, all these banks except one started on the basis of unlimited liability. The exception was the General Bank of India† which had a strictly small number of shareholders who limited their liability to certain figures.

After the battle of Plassey, the currency of Bengal and of the Company's territories generally was found in a chaotic

* Commerce, 4th September 1926, p. 461.

† Early European Banking, by H. Sinha, pp. 12; 15; 23. While subscription was open to all "without distinction of country or religion" the number of shareholders was limited to 400 and each share was of the value of Rs. 5,000.

condition. It was recognised very early that introduction of paper currency must form an important part of any permanent and satisfactory scheme of reform. Contrary to the advice of Sir James Stuart, the famous economist of the time, Hastings made a proposal to have a government note-issue. Outbreak of war and disturbed conditions generally forced him to abandon the scheme. The Government thereafter changed its policy and decided to encourage private agency.*

The joint stock banks which saw now the light of day and others which were proposed but rejected by the authorities of the East India Company were frequently inspired by comprehensive ideas of banking policy. The inconvenience to trade and commerce of large, periodic withdrawals of funds into government treasuries at the head-quarters, the need of facilities for expeditious transfer of funds, whether public or private, the obvious usefulness of such agencies to put into circulation some standard coin like the sicca rupee—these objects figured in many minds which initiated these ventures.† Even in these very early stages just as in the many long decades which followed, people had a haunting dream of one great "State Bank" or "General Bank" which, with many branches in the country, should build up the banking structure of India.‡ The immediate and perhaps the most outstanding and permanent achievement of these banks was the introduction of a note-circulation in this country.

* Economic Annals of Bengal, by J. C. Sinha, pp. 110-146.
Early European Banking. H. Sinha, pp. 48-53.

† Hence Warren Hastings' "General Bank in Bengal and Bihar" established in 1778 and dissolved shortly thereafter. It had a branch in every collectorate and its two managers were Indian shroffs.

‡ Robert Rickards, a member of Government of Bombay proposed his "General Bank" in 1806. The proposal was rejected by the Court of Directors.

In 1836, merchants in India proposed the "Great Banking Establishment for British India". The proposal was rejected by the Court of Proprietors.

In his Minute of 1859, James Wilson, Finance Member, made clear that his scheme for paper circulation was not intended to discourage the idea of a great country-wide bank.

In 1862, Samuel Laing wrote a minute to advocate conversion of Presidency Banks into a State Bank.

In 1867 Dickson, Secretary to the Bank of Bengal made proposals to amalgamate the Presidency Banks.

In 1870, Ellis, a member of Council, proposed a State Bank on lines of the Bank of France.

Sir E. Hambro in his minute to Fowler Report (1898) suggests a Central Bank for India—as also Sir Edward Law in a Minute in 1901.

Sir E. Holden advocated at the General Meeting of the London City and Midland Bank in 1918 a Central Bank for India in order to draw out gold into monetary circulation and cause a lowering of interest-rates.

Keynes in the Annexe to Chamberlain Commission's Report elaborates a scheme for the purpose. See also pp. 357, 359; Indian Finance and Banking, by G. F. Shirras.

The Bank of Hindusthan established as early as 1770 by the Agency House of Alexander & Co., led the way. Its maximum circulation seems to have varied between 20 and 25 lakhs.* The Bengal Bank, launched into existence before 1786, had a cirulation of 8 lakhs when it closed its doors in 1791, owing largely to the panic of wars with Tipu Sultan. These banks competed very keenly for the privilege of having their notes made receivable "at all offices of Government at the Presidency" or "in all payments to Government at different treasuries and public offices at the Presidency." The choice of the Government fell at first on the General Bank of India, which however was dissolved in 1793. The Government sponsored thereafter the Bank of Calcutta founded by Palmer & Co., in 1806. In the description of its objects and reasons, the development of paper currency was specifically stated as the most important advantage to accrue from the institution. By 1820, its note circulation had reached the figure of 43 lakhs.† Naturally, the notes of these banks were not much in evidence beyond the outskirts and environs of Calcutta.

Similar enterprises were springing up in other parts of India also. A bank of deposit and discount made its appearance in Madras as early as 1688. Another bank commenced operations in Bombay in 1724 and a little later, was given the privilege of note-issue to the extent of Rs. 8 lakhs. Both had the sanction of the Court of Directors of the East India Company and were managed by the local governments in the interests of their own financial needs. Madras had a few banks more, later on, including a private joint stock bank named the Carnatic Bank and another Government Bank. These banks also rendered valuable service in making paper currency familiar to the public.‡

The Agency Houses were overtaken by a crisis in 1829-30. Among those which perished were Alexander & Co., Colin & Co., Fergusson & Co., McKintosh & Co., Cuttendon & Co.,

* B. T. Thakur in "Organisation of Indian Banking," p. 27 gives 50 lakhs as the maximum. No authority is quoted.

† Banking, by Cook, p. 201.
Early European Banking, by H. Sinha, pp. 38; 40; 136; 145.

‡ Present Day Banking in India, by R. Rao, pp. 165-182.

Palmer & Co., etc. Seven or eight of these alone are reported to have lost 15 million pounds.* With them were dragged into insolvency the associated banks as well.†

After the crisis and till 1860, banking activity proceeded with moderate zeal.‡ Out of 12 banks launched between 1833 and 1860, however, about half failed. Some of them were mere frauds made possible largely by the laxity of law. Others ventured upon imprudent investments in industries. Everyone of them was an European enterprise.¶

The most permanent institutional gain and achievement of this period was no doubt the emergence of the three Presidency Banks destined to play great part in the history of Indian banking. The Bank of Bengal established in 1806 received its charter in 1809. The Banks of Bombay and Madras were founded in 1840 and 1843 respectively. They were intended to facilitate the borrowing operations of the East India Company as well as the trade of British merchants.§

II. 1860-1900

For forty years, 1860 to 1900, banking and banking habit made but small headway among the people of this country. In the last three decades, the three Presidency Banks and Indian joint stock banks added to their capital a mere three crores and to their deposits only fourteen crores.‖ These

* Commerce, 4th September 1926.

† The Bank of Hindusthan perished with Alexander and Co., in 1832. It suffered a run in 1819 on account of extensive forgeries of notes. The failure of Palmer and Co., caused another run in 1829 when Rs. 20 lakhs were paid out.

Evidence of Larpent. House of Commons Committee on State of Manufactures, Commerce and Shipping, 1833.

‡ For a list of the banks of this period compiled from Cook's Banking in India, see, Indigenous Banking in India, by L. C. Jain. p. 148.

¶ The Union Bank. It was established in 1829 with a capital of 15 lakhs. In 1840, frauds by A. H. Sim, Accountant, were discovered. He had misappropriated assets coming into his hands and made false entries. When in 1848 this bank along with its rival the Calcutta Bank was closed, it was found that dividends had been paid out of capital and deposits while the directors also had helped themselves to the funds. Some of the loans amouted to 1/4 to 1/6 of the capital. The bank was also deeply involved in indigo plantations.

Benares Bank was established in 1844-45. It invested the whole of its capital practically in the losing Ganges Steam Navigation Co. It was discovered that the directors and many others had purchased the bank's shares with loans from the bank itself. The directors were all army men and were dismissed.

§ pp. 75-76.

‖ The phrase "Indian Banking" is meant to be exclusive of Exchange Banks only Some Indian authors (e.g. Jain, Indigenous Banking in India.) exclude Presidency Banks as well. Except for the fact that the directorate and the higher staff of the Banks are drawn from Britishers there is no sufficient warrant for the procedure. (See Chapter IV, pp. 91-92.) It is necessary to emphasise that in this and the next Chapter, the progress of banking is assessed only with reference to the Imperial Bank, Exchange Banks and Indian Joint-Stock Banks, Class I (with capital and reserves of five lakhs and above) and Class II (with capital and reserves between 1 to 5 lakhs.) For some discussion about smaller banks for which no statistics are available. See pp. 84-85; 140-146.

figures for such a lapse of time appear modest when compared with the addition to capital of 4 crores and to deposits of 29 crores in the next 13 years.*

The city of Bombay had indeed seen an extraordinary flotation of banks during the speculation fever of the American Civil War. As many as 25 banks with a paid-up capital of 13·6 crores and 39 financial associations with paid-up capital of 6·2 crores were conjured into existence in the short space of three years 1863-65. Of the banks, four including the Bank of Bombay were old concerns which were tempted to enlarge their capital enormously during the speculation wave. The premia collected on the bank-shares alone has been estimated at 10·7 crores. Unfortunately, all this financial and banking enterprise was a mere incident in the fantastic speculations in land and other forms of wealth prevalent at the time and when the speculation itself collapsed, not a vestige was to be seen of the colossal financial fabric reared to support and stimulate it.†

It has been suggested that the uncertainties of exchange explain the slow rate of banking progress.‡ It is of course natural that instability of exchange should have caused much hesitation, additional cost and difficulty in the financing of our foreign trade. Complaints to this effect were heard in plenty both before the Herschell and Fowler Committees. Nevertheless, it is most unlikely that exchange instability could have affected the business of banks other than the highly developed Exchange Banks and should not, for that reason, be held responsible for the slowness of domestic progress in this direction. Besides, even in those years, the technique of covering exchange risks was certainly not less well known and not less available than today. As the Herschell Committee state in their main

* Presidency and Indian Joint-Stock Banks. (Figures in lakhs)

	Capital.	Deposits
1870	872	658
1880	426	912
1890	498	1,746
1900	696	2,085
1906	830	3,900
1913	1,112	5,907

Deposits of Presidency Banks include private deposits only.

† A Financial Chapter in the History of Bombay City, by D. E. Wacha, pp. 24-82.

‡ Indigenous Banking in India, by L. C. Jain, pp. 140-151.

Report, there is no adequate proof either in the statistics of our foreign trade that growth in its volume was retarded or that exports were stimulated at the expense of imports.*

It accords better with facts to say that the slow progress of banking in India was but a reflection of the almost stationary economic conditions in the latter half of the 19th century. Instability of exchange could hardly be blamed for this general stagnation of economic life. Improvement no doubt occurred now and then. But it was more than destroyed by recurrent famines and long periods of mere recovery and recuperation had to supervene. In the absence of figures of national income, etc.,—and at best, they are rarely unambiguous and dependable,—evidence of a piecemeal or general character is the only basis for forming impressions on the subject. But among those who have examined the facts attentively, there is and should be hardly any ground for disagreement on this point. It is indeed the inevitable theme of every student of the period.†

Among important factors which presumably shared responsibility for this outcome, the factor of special significance for banking is the course of prices and state of currency.‡ After the inevitable reaction to the high prices of the American Civil War, the Indian price level continued low with a downward trend till 1885-86. It then improved, made striking strides in 1891-93 and then got involved in the currency and famine turmoils of 1893-1900. The prices of indigenous manufactures with which the city-located banks were most directly concerned continued low and falling from 1866 to 1886, recovered appreciably between

* Report of Herschell Committee. Paras. 24 ; 25 ; 26 ; 27.

† Currency and Prices, by Vakil and Muranjan, pp. 347-51; 364-65 ; footnote p. 357.

‡ Ibid. pp. 312-22 ; Tables, pp. 308-09 ; foot-note p. 318.

	General Price Level.	Price-Level Manufactures. (1878-100)	Purchasing Power of Silver over commodities in England.
1866	134	83	...
1869	101	81	...
1870	107	94	...
1871	93	96	100
1886	96	74	123
1896	121	92	96
1899	99	75	...
1900	112	84	...

1888 and 1893 and fell heavily thereafter till 1899. Such a course of events was obviously ill suited to stimulate growth of deposits and banking in a backward country like India.

In 1870, there were only two Indian joint stock banks with capital and reserves of 5 lakhs and more. By 1900, the number increased to 9. The most important among them were the Allahabad Bank of India (established in 1865), the Alliance Bank of Simla (established in 1874), the Oudh Commercial Bank (established in 1881), and the Punjab National Bank (established in 1894).

While the progress of banks and banking in general was very slow till 1900, one constituent of the banking system passed through a remarkable phase during the last decade. Indian joint stock banks were hardly in evidence in the two decades 1860-80. During the next decade, they gained in size and strength. But in the last decade, they made a substantial gain of more than 5 crores in their deposits while Exchange Banks showed a betterment of 3 crores only and the Presidency Banks actually lost ground by 2½ crores. The Allahabad Bank alone recorded an improvement of 1½ crores.*

As our analysis elsewhere shows,† the last decade witnessed a sudden and remarkable boom of investment in this country. It is probable that the pressure of this boom and its subsequent collapse fell very largely on the Presidency Banks which had to supply cash to meet the two phases. The initial fall of interest on the other hand

* (Figures in lakhs.)

	Number.	Capital and Reserve.	Deposits
1870.			
Presidency Banks	3	361	639 §
Exchange Banks	3	2.1 (m. £s)	53
Indian Joint-Stock Banks	2	11	14
1880.			
Presidency Banks	3	405	840 §
Exchange Banks	4	3.0 (m. £s)	339
Indian Joint-Stock Banks	3	21	63
1890.			
Presidency Banks	3	447	1,476 §
Exchange Banks	5	8.0 (m. £s)	753
Indian Joint-Stock Banks	5	51	270
1900.			
Presidency Banks	3	559	1,228 §
Exchange Banks	8	15.7 (m. £s)	1,050
Indian Joint-Stock Banks	9	127	807

§ Private deposits only.

† See pp. 44-48.

placed Indian joint stock banks in an advantageous position since more than three-fourths of their deposits were probably fixed deposits and rates offered by them have been always very attractive. Perhaps, the Government also aided them by reducing their rate on postal savings deposits to 3¼ per cent. It is not surprising then that they should have acquired 4 crores out of 5 in the years 1891-97, partly at the expense of Presidency and Exchange Banks but partly out of new sources also.*

* Private Deposits (in lakhs).

	Presidency Banks	Exchange Banks	Indian Joint-Stock Banks.	Total
1890	1,476	754	271	2,501
1891	1,413	863	346	2,622
1892	1,267	853	387	2,507
1893	1,210	813	408	2,431
1894	1,313	976	450	2,739
1895	1,312	1,018	566	2,909
1896	1,292	1,015	538	2,845
1897	1,016	909	681	2,606
1898	1,078	949	689	2,716
1899	1,141	1,070	743	2,954
1900	1,288	1,050	808	3,146

CHAPTER II.

PRESENT CENTURY PROGRESS

QUANTITATIVE estimates of progress of banking and banking habit is in itself beset with many inherent difficulties. The absence of or inaccesibility to relevant statistics on this subject makes such a task in this country even more impracticable. The measure most easily available and ordinarily employed is the size of banking resources—the capital, reserve and deposit-liabilities of banks. But the use of this measure is valid only within certain limitations. In particular, it is not easy to discern how far changes in deposits are a reflection of changes in price-levels, growth of wealth in general, extension of facilities to new areas or classes, improvements in banking habit, technique, etc.

Absolute Progress of Banking Resources

Between 1900 and 1914, the deposit liabilities of Presidency, Exchange and Indian joint stock banks recorded an addition of 57 crores. Between 1914 and 1920, the gain in deposit resources amounted to 139 crores. The year 1920 was, however, an exceptional one, being at once the climax and collapse of the War and post-War inflation. If we adopt the year 1922 as representing a substantial restoration of more normal conditions, the improvement should stand at 107 crores instead of 139.

It is a commonplace of Indian economic history that the first 20 years of the present century saw remarkable fluctuations in the rupee price-level. Between 1899 and 1914, prices mounted by about 30 per cent. The war caused a degree of inflation which left the price-level even as late as 1922 about 84 per cent. higher than in 1914. In these circumstances, it is very difficult to ascertain how far the growth in deposits was a mere concomitant of the rise in price levels and how far it represented a broadening or intensification of our banking structure. If index-numbers

of prices could be accepted as reliable correctives for the price factor, about 5/7th of the growth between 1900-14 should be regarded as real, taking as our basis of comparison the purchasing power of the Rupee in 1899-1900. In terms of the purchasing power of the rupee in 1914, the real growth in banking resources between 1914 and 1922 should be placed at a little more than half the nominal growth. As experience teaches, however, such reliance on index-numbers of prices is not fully warranted.

The twenties of the present century present a very unusual period. Taking 1922 as a fairly normal year, the third decade seems to have been largely stationary in point of growth of deposits. A slight upward movement is visible but it could hardly be described as progress. This stationariness is in a large measure the reflection of the steady deflation of prices which was occurring throughout these years. The Calcutta-Bombay wholesale index-number stood at 188 in 1920, 176 in 1922, 143 in 1929 and 121 in 1930. In the light of this persistent fall of prices, the small improvement of 1922-1929 even must be looked on as evidence of the growing strength of the banking system.

By 1931, the price-level passed in its downward progress the level of 1914. The aggregate deposits of the Indian Banking system then stood somewhere between 212 and 197 crores as against 87 crores in 1914.

The great deflation of prices initiated by the world-crisis of 1929, was largely concentrated in India on the years 1929-1931 when the Calcutta-Bombay index-number fell from 143 to 102. By 1936, prices settled down to about 94. It is remarkable that only in 1931, there was recorded a sharp diminution in the deposits of Indian banks. Between 1930 and 1936, the Indian banking system as a whole took another stride forward by acquiring about 45 crores of deposits more.*

* We have measured the growth of banking habit and banking power in the country exclusively by the growth of deposits. The volume of cheque clearances is another index which however suffers from the shortcoming that cheques drawn on and paid into the same bank do not naturally figure at the clearings. It is likely that such cheques run into a larger volume in India than elsewhere. Column in Table I records the growth of cheque clearances and in Column the figures are corrected for price changes by an index-number for internal price-level. We owe the figures to Dr. Meek, the Director of Statistics. (pp. 881-88 Journal of the Royal Statistical Society, Part III, 1937). The highly inflated figures for 1920, 1928 and 1929 prove how cheque clearances are a better measure of business activity than of banking habit.

Place of Banking Funds relatively to Other Funds

Banks are only one among several reservoirs into which the savings of the community flow. These other reservoirs are by no means on all fours with banks. The quality and character of the resources attracted by each are by no means identical with those of others and to that extent, the comparison is subject to certain qualifications. Nevertheless, as long term and short term funds are distinguishable only in degrees and not in kind and as the field of contact between them is a wide one, the place of banking funds relatively to other funds is certainly a matter of deep economic significance.

There is another qualification which we must bear in mind on this subject. There exist some important forms of investment for which we have no comparable statistics. Building activity, for example, absorbs in many countries about half the annual national savings. There are also large annual investments made from year to year on other than joint stock basis. Even with these omissions, the trend of banking funds relatively to other funds cannot but be an important index to the direction of economic growth in this country.

The relevant statistics are brought together in the following table.

	Private Deposits of all banks.	Post-Office Savings Accounts Closing Balances.*	Postal Cash Certificates.*	Total Working Capital of Co-operative Societies.	Paid-up Capital Joint-Stock Companies†	Life Assurance Funds.**	Permanent Rupee Debt of India.$	Net Imports, Net Exports Gold and Silver (in previous decade.)‡
				(Figures in Lakhs.)				
1890	2501	685	...	...	2445	11	102	19027
1900	3146	1004	...	...	3609	52	115	10055
1910	3231	1692	...	331	6383	233	138	22764
1920	22026	2286	436	3656	16431	846	257	53600
1930	22122	3700	3800	9191	28259	2557	494	34536
1936	25186	7467	6440	10159	31145	4029	475	

* For a fuller analysis. pp. 402-403.

† An addition of 5 to 10 per cent. must be made for amounts carried to reserve annually.

** For a fuller account, pp. 399-402.

$ For a fuller account pp. 395-97.

‡ See pp. 403-406.

From our present stand point, the increments which have occurred from year to year are more important than relative absolute size. As a topic of familiar admonition, investment in precious metals arrests attention first. It is clear from this table that this form of investment is absorbing a diminishing proportion of our visible savings from period to period. Between 1890-1900, precious metals acquired were equal in value to 2/3rds of our aggregate visible national savings. The proportion fell strikingly in the next decade 1900-1910 and in the next two decades, other forms of investment far out-stripped this particular form. So long as there is only a limited outlet for investment in urban property and peasant-proprietorship prevails in agriculture, India is bound to have more need of gold and silver than many other countries. Even so, the large net exports of gold from 1930 onwards present a novel feature the ultimate significance of which is a subject on which one can only speculate at this stage.

Among other claimants for our national savings, government and joint stock companies are the most powerful rivals to banks. The borrowings of government have always been an overshadowing factor in this country. Except for the decade 1920-30, they were exceeded only by the value of imported precious metals while other investments amounted to only a fraction. After 1910, however, the capital of joint stock companies has shown a great capacity for expansion and is now a good rival to government borrowings.

Since the close of the War of 1914-18, banks are encountering another rival, post office savings banks and postal cash certificates which attract the small man's mite. Funds flowing into assurance companies must be placed largely in the same category.

The general import of these changes deserves some closer analysis.

Since the end of the last war, the world has seen two rival tendencies in the financing of trade and industry. In several countries, notably in the United States, industrial

and commercial enterprise has increasingly sought to make itself independent of banks and to rely on its own resources raised directly. Such a policy tends to divert funds from banks into stocks and shares, particularly those funds which are ordinarily placed with banks as fixed deposits. The other counteracting tendency has been caused by the abnormal post-1929 fluctuations in the values of equities. In certain countries, people are now inclined to prefer the safety and liquidity of fixed deposits to the risk of investment in industrial issues.

It does not seem probable that the American horror of indebtedness has become an important factor in this country. The recent growth of joint-stock capital is very largely due to rapid industrial development of the country. The second tendency has been more visible in India, as our analysis will show presently. The growth of fixed deposits however has not been sufficient to maintain the growth of banking funds in general—which must be ascribed as much to the gathering momentum of the deflation of post-war years as to certain other factors to be noted presently.

Government borrowings have been a great competitor of banks in all countries. In post-war times, the demand of State and public authorities for capital expenditure has increased very much. India has been no exception. In the earlier years budgetary deficits, and later the needs of development expenditure, constantly raided national savings—with the inevitable deflationary effect on banking funds.

Perhaps the most durable change of post-war years is the growth of thrift—thrift especially among the lower income classes. It has been estimated that, in some countries at least, the thrift of these classes has become the major source of capital formation. Apart from thrift, technological progress in production, slow or rapid fall of prices, much social and ameliorative legislation have been factors influencing the distribution of wealth more and more in favour of these classes. The effect on the position of banking funds and commercial banks generally has not been quite the same everywhere. In those countries in

which these savings have been always relatively unimportant, the fraction of total deposits held as postal *savings deposits has continued fairly unchanged. Such is* the case with United Kingdom, the United States and South Africa. But in other countries like Norway, Sweden, New Zealand, Australia, etc., the fraction is today strikingly larger than it was in 1913 and commercial banking has to that extent lost ground.* India falls clearly in the second category. The growth of postal savings and cash certificates has been truly astonishing. The banks themselves assisted the growth of this type of savings by instituting savings bank accounts. The figures of savings deposits which are available separately for the Allahabad Bank of India and the Mysore Bank illustrate this fact very forcibly.†

In short, the relative part of commercial banks in the accumulation and disposal of savings in general seems to have suffered some decline in recent years. The same fact has been noted of many other countries as well. But the causes of this outcome are not the same everywhere. In France, Germany, Italy, Japan, etc., the volume of deposits held by commercial banks improved relatively to all deposits between 1913 and 1925 but lost ground heavily thereafter, due no doubt to severe deflation. Deflation as an important factor became active in India only after the 1929 crisis. The cause of a similar decline in the position of commercial banks in other countries is the increase of savings deposits. New Zealand, Norway, Sweden are such countries and there is little doubt that India must rank among them. It is however, not likely that this decline will be a permanent feature in this country. Banking is still in its early stages of development and, sooner or later, the normal tendencies of growth must assert themselves. It is worthy of note in this connection that those countries, in which banking has developed very highly,

* Savings Banks and Postal Deposits as p.c. of total Deposits.

Norway 67%	Australia 48%
Sweden 47-50%	United Kingdom 27%
New Zealand 48%	United States 21%
South Africa 10-16%	

Monetary Review. Vol. I, p. 77 (League of Nations.)

† pp. 206; 208 & 217; Tables XXI & XXII; Table XXV and Table XXVI.

commercial banks have maintained their relative position despite the aforesaid forces.*

Constituents of Indian Banking System.
Their Contribution to Growth.

While the present century has seen more or less uninterrupted growth of the Indian banking system, the progress of the constituents of the system has occurred at different rates. These uneven rates of growth mean far-reaching changes in the quality and strength of the whole banking structure.

Till 1906, the Presidency and Exchange Banks maintained their accustomed lead in general growth. As compared with 1900, the increase in deposits amounted to 15 and 8 crores respectively. During the same years, the Indian joint stock banks added to their deposits full 11 crores only.†

The succeeding wave of Swadeshi sentiment altered the trend. In the few years from 1906 to 1913, Indian joint stock banks added to their deposits full 11 crores against 9 crores of Presidency Banks and 13 crores of Exchange Banks. The setback of 1913 struck Indian joint stock banks appreciably. But the advent of war conditions arrested any tendency to prolonged decline. In the war years, 1914-1920, these banks with their aggregate gain of 54 crores maintained their progress against their two rivals which acquired 38 and 44 crores only.

The years 1920-30-36 reveal unusual developments. The crisis and deflation of 1920 caused a sharp and general contraction of about 1¼ crores in the case of Presidency Banks, more than 6 crores in the case of Exchange Banks and full 8 crores for Indian joint stock banks. By 1922, however, quieter conditions were restored. While the aggregate deposits of the Indian banking system remained more or less stable for the next 8 years a noteworthy redistribution of resources took place among the constituents of the system. The territorial expansion of the

* Bank Deposits as p. c. of Total Deposits: Canada 92%. British Banks 70%. United States 80%. Monetary Review Vol. I pp. 72-73; 77; 75-76 (League of Nations.)

† class A only.

Imperial Bank of India added 19 crores to its deposits while Indian joint stock banks improved their position by about 2 crores. Their betterment was partly at the expense of Exchange Banks which in spite of some increase in their branches continued to lose ground and recorded a further contraction in deposits of 5 crores by 1930.

Again in the great accession to resources of 45 crores between 1930 and 1936, these banks participated in a very unequal manner. The Imperial Bank showed a betterment of 2 crores and the Exchange Banks of about 7 crores. The bulk of the improvement was contributed by Indian joint stock banks whose deposits grew by about 35 crores.*

These unequal rates of growth are inevitably reflected in the relative position of the constituents of the system from time to time. In 1914, Indian joint stock banks held only 21 per cent. of the aggregate deposits of the Indian banking system. By 1920, their share rose to 32 per cent.—gaining ground exclusively at the expense of the Imperial Bank of India. The creation of 100 new branches between 1921 and 1930 increased the share of the Imperial Bank slightly, gaining a little advantage over the Indian joint stock banks which made a small absolute gain and the Exchange Banks which were actually losing deposits. But between 1930 and 1936, the share of the Indian joint stock banks rose from 31·6 to 40·2 as against a fall from 36 to 30 per cent. in the case of the Imperial Bank which increased its deposits slightly and a fall from 32·4 to 29·1 per cent. in the case of Exchange Banks which had more than repaired the contraction of 1922-30. It is a noteworthy feature of these developments that the share of the Exchange Banks was steady till 1920 and thereafter began to decline.

In all the changes noted till now, the position and progress of Indian joint stock banks of B Class appear very remarkable. Between 1914 and 1922, their gain in deposits was Rs. 80 lakhs. Between 1920 and 1930, when the other constituents of the Banking System with the exception of the Imperial Bank of India were marking time or losing

* See Table I.

deposits, they actually added to their deposits 2 crores. The years 1930-1936 record a further improvement of 1¼ crores. Anticipating a little of our later discussion, we may note that this growth has been largely a growth in numbers rather than in size. The deposit resources per bank improved under the influence of war inflation from an average of about 5 lakhs to an average of about 7 lakhs in 1920. But thereafter, the average has continued almost stable, the actual figures being 7·06 for 1920, 7·90 for 1930 and 7·4 lakhs for 1936.*

Nature and Character of the Growth.

Geographical Expansion.†

Apart from the influences exerting on the relative sizes of banking funds and non-banking funds, the real growth of the former is an outcome of several interdependent and inseparable factors. The growth of wealth itself, the efforts of banks to reach newer and newer levels of income-classes, geographical expansion of banks,—these are the more obvious ones which inevitably suggest themselves. We have now to estimate as accurately as we can, how far each of these factors explains the changes already described.

In the growth of banking funds, creation of new branches and expansion of area over which banks operate have inevitably played a notable part together. Between more intense exploitation of existing areas and extension to virgin fields, however, the former factor seems to have predominated. Except for the war years, when inflation made cities fruitful areas of banking activity, the average of branches per place with banking facilities fell from 2·47 to 2·15 between 1916 and 1926. But after the Imperial Bank ceased to pioneer branches in 1926, the average per place has risen continuously from 2·15 in 1926 to 2·82 for 1936. Except for the post-war year 1920, the latter figure is the highest on record.

There was no doubt once a tendency‡ to exploit more and more intensively the 5 big up-country centres of trade

* Pp. 84-85; See Chapter V 140-47.

† The subsequent discussion should be taken with the general background described in Chapter X, generally and pp. 289-40; 287-97; 321-41; 362-65 in particular.

‡ Q 7940; 8058; Minutes of Evidence, Chamberlain Commission.

and commerce* and the 4 great ports of India.† Even as late as 1916, about 32 per cent. of the total head offices and branches were concentrated in these few places. The percentage has declined continuously thereafter to about 16 in 1936. As between the up-country centres and the ports, the absolute increase of branches in the former places has been 23 only between 1916-36 as against 85 for the latter. Partially at least, this must be due to the fact that, as in all other countries, country banks find it an advantage to have direct representation in the great financial centres and money markets of the country.‡

There are 2,300 towns in India with a population of five thousand and over. Of these, only 140 had any banking facilities in 1916. The number increased to 339 in 1926 and 514 in 1936. The greater part of the extension occurred in the small space of years 1920-26 and 1930-36. In the earlier period, the expansion of the Imperial Bank of India according to the terms of the Charter of 1921 created a general eagerness to expand before it was too late and as many as 154 new places were added to the list. During the depression years, 121 more towns were placed on the banking map of India in spite of the much stronger tendency on the part of rival banks to concentrate on the exploitation of the same places.

The creation of banking facilities in any place is largely determined by the volume of deposits or scope for investment which it may furnish. While many other factors are usually taken into account before reaching a decision to open a branch, population by itself is as a rule a fairly good index to banking potentialities. Judged by this standard, extension of banking seems to have proceeded in a haphazard way rather than on a systematic plan. The figures for 1936 throw very instructive light on this aspect of the problem. Of 373 places which have a population of 20,000 and more, about 230 or about 62 per cent. had banking facilities in that year. Of 632 places, which were inhabited by more than

* Lahore, Delhi, Amritsar, Lucknow and Cawnpore.
† Bombay, Calcutta, Madras and Rangoon.
‡ Table II.

10 and less than 20 thousand people, 91 or about 14 per cent. were endowed with some bank or branch of a bank. Of the rest 1,295 places, 186 or about an identical percentage has similar facilities.

It is true that a considerable improvement has been taking place in the direction of extension of banking facilities to smaller places. A comparison of place distribution of banking facilities in 1921 and 1936 reveals this tendency very clearly. In 1921, a little over 19 per cent. of places with banking facilities had populations below 10 thousand. The percentage rose to 36 in 1936. The percentages for places with populations above 20 thousand confirms the same fact by a consistent decline. When it is recalled that the places comprised in the analysis were 198 in 1921 and 507 in 1936, the greatness of the change in the structure of Indian banking will be easily realised. As we shall discover presently, the change is not a little due to the emergence of small banks.*

It is perhaps inevitable that the bigger places in the country should attract banking enterprise first. Still, the omission of 40 per cent. of places with a population of 20 thousand and over is in itself not a little surprising. It seems to indicate that preliminary exploration and mapping out of banking potentialities do not play their due part in banking development.

To a certain extent, the haphazardness and irregularity of our present distribution of banking facilities are no doubt explained by the general avoidance of Native State areas by responsible British Indian banks.† That this prudence has ample basis in fact is amply proved by the occurrences connected with the recent failure of a Native State bank which had a large extension in British India territories. The numerous difficulties legal, judicial and administrative which arose during the liquidation of the

* Table III & IV.

† In 1934, out of 108 important Native States, only 20 had banking facilities. The number of places for the more important States are given below :—

Mysore	... 21	Kashmir	... 4
Travancore	... 15	Gwalior	... 2
Baroda	... 12	Porbunder	... 1
Hyderabad	... 9	Jaipur	... 1
Cochin	... 9	Jodhpur	... 1

Travancore National and Quilon Bank are a sufficient warning to British India enterprise for the future.*

It is more than probable, nevertheless, that the present distribution of banking facilities is the outcome of lack of initiative, adventure and planning on the part of our banking community. The general tendency is that some adventurous bank pioneers a branch in a new place and others hasten in its wake in an indiscriminate manner. A comparison of the present place-distribution of the branches of the Imperial Bank with that of the Big Five of the Indian joint stock banks confirms this surmise in an emphatic manner.† In the year 1936, the Imperial Bank was spread over 156 places. The Allahabad Bank existed in the same year in 36 places but of these, in only three was the Imperial Bank unrepresented. The Central Bank of India had branches in 52 different places but it was free from the competition of the Imperial Bank in only 12 places. The Punjab National Bank was active in 46 places but its operations were free from the shadow of the Imperial Bank in only 15 places. The Bank of India, rigidly confined as it is to about 7 big cities of India naturally encountered competition from almost all its big rivals. Of the 23 places in which the Indian Bank of Madras operated, the Imperial Bank was absent in only 4. The Bank of Baroda was the only big bank which enjoyed immunity from the Imperial and other banks. It was in exclusive ownership of its areas in as many as 16 out of 22 places. This immunity is largely due to the fact that it is largely located in the territories of the Baroda State. Even in the case of the Central Bank of India, many of its places of exclusive jurisdiction are situated in the territories of Native States. It is clear from this how Indian banks as a rule are content to take advantage of the pioneer work of some exceptionally adventurous or privileged bank.

Of 514 places which had banking facilities in 1936, the Imperial Bank, the biggest five of Indian joint stock banks

* See pp. 317-19.

† Big Five i.e. Bank of India ; Central Bank of India; Allahabad Bank; Punjab National Bank and Bank of Baroda ; Big Seven : these five and Bank of Mysore and Indian Bank of Madras.

and the Indian Bank of Madras were represented in approximately 194 places. It is very unlikely that Exchange Banks were represented in places other than these 195 towns. In other words, about two-thirds of the places with banking facilities in 1936 were dependent for them on the smaller Indian joint stock banks belonging to class A & B in the country. As the progressive rise in the proportions which the more populous places bear to the total number occupied by the bigger banks indicate, the smaller banks are concentrated in the less populous, smaller places.*

It would not be correct to infer from this that the smaller places outside the orbit of the bigger banks do not possess adequate banking potentialities. The place distribution in 1936 of the aforesaid bigger Indian banks itself contradicts such an inference. Of 194 places mentioned above, 37 or about 19 per cent. had less than 20 thousand population. Of the class immediately above it, *i.e.* places with population between 20 to 30 thousand, there were 32 or about 16 per cent. The first percentage is no doubt low as compared with the figure for all places with banking facilities which stands as high as 55 per cent. Even though the smaller places are thus occupied predominantly by smaller banks, the percentage 19 is quite a substantial proportion and suggests large scope for extension to such areas. This surmise is much confirmed by the performance in this direction of one of the Big Five and decidedly a well-managed institution, namely, the Bank of Baroda. Of its 22 branches in 1936, as many as 13 *i.e.* about 60 per cent. were concentrated in places with population below 20 thousand. Yet, this has not affected either its liquidity or its profitability.

Branch Expansion as a Factor in Growth

We have recorded above that multiplication of branches has been a more marked feature of the growth of our banking system than extension to new places. Growth in resources and in the number of bank-branches shows a parallel movement. 198 new branches between 1916-1920, 402 between 1920-1930 and 512 between 1930-1936—this

* Table III.

shows indeed a momentum which is progressively gathering strength. Between 1916 and 1936, the aggregate branches and offices of banks in India more than quadrupled themselves. Unlike extension to places, growth in branches is taking place at an even rate—which marks it out once more as the more easily available line of expansion for most banks.

The same factor explains more or less the lines and rates of growth in the resources of the constituents of the banking system. The competition for new branches has rested chiefly between the Imperial Bank of India and the Indian joint stock banks. During the war, the Presidency Banks were almost quiescent. In the short space 1916-1918 Indian joint stock banks added on the contrary 71 branches, *i.e.*, as many as the Presidency banks then had. This should be sufficient to explain the striking improvement in relative position which these joint stock banks made at the expense of the other constituents.* Between 1920 and 1930, the Imperial Bank and Indian joint stock banks competed very keenly for opening new branches. Of 402 new branches then created, the new statutory branches of the Imperial Bank ran into 100 while the new branches of its competitors easily exceeded 250. While the slow fall of prices of those years over-shadowed every other factor in growth, the relative position of these rivals remained almost the same—with perhaps a slight improvement in favour of the Imperial Bank.

The situation changed in a very striking manner after 1929-1930. After creating its statutary 100 branches by 1926, the Imperial Bank decided on a policy of consolidation and hardly made any addition to its branches.† The Indian joint stock banks embarked on a spate of branch creation which accounted for 502 out of 512 new branches which appeared during this period. The striking absolute gain and the still more striking relative gain of these banks in these years are thus easily explained.

The Exchange Banks maintained their relative position till 1920. But thereafter they lost position both absolutely

* See p. 15.
† See p. 19.

and relatively till 1930 and later only relatively. It has been claimed officially on their behalf that their policy is to refrain from creation of branches in the interior unless their clients demand such facilities for the particular kind of business in which these banks specialize. Only 45 in 1916, the branches of these banks increased to 77 in 1926 and to 99 in 1936. The growth in numbers has been evidently slow and is tending to be slower and slower.*

Of 1450 branches, head-offices and agencies in existence in 1936, 99 belonged to Exchange Banks and 360 to the Imperial Bank of India. Of the balance of 991, about 275 were claimed by the 6 biggest Indian joint stock banks. In other words, more than 700 *i.e.*, about 1/2 the number of bank-offices in the country were created by the smaller Indian joint stock banks of class A & B. These banks, it will be recalled, operate exclusively over about 2/3rds of the places with banking facilities in this country.

The distribution of the branches of the seven biggest Indian joint-stock banks over places follows more or less closely their distribution on the basis of population. The only notable departure, as may be guessed, occurs in the highest population class. Places with populations of 1 lakh and more form only 16·4 per cent. of the aggregate number of places. But as many as 24·4 per cent. of branches are concentrated in them.†

Structural and Financial Implications of Geographical and Branch Expansion.

When expansion of banking facilities occurs as a consequence of creation of branches by a few big banks, it means an accession of strength and consolidation to the whole system. Among other gains, diversification of risks which such expansion brings with it must be counted as the most important factor making for stability. Even if expansion causes a fall in the average of resources available per branch, such a fall, while it may detract something from the profitability of banks, detracts nothing from the

* "......there are no branches of Exchange Banks in 6 out of 9 provinces in India...... In almost all these places, certain Indian joint-stock banks have opened branches long after the establishment of branches by the foreign exchange banks." Para 517, Banking Enquiry Committee Report.

† Table IV.

strength of the structure. The reverse consequences are to be feared when expansion ensues from a mere multiplication of smaller banks and their branches—particularly when a country lacks the means to organized action in the money-market.

Such geographical and branch expansion as has taken place in recent years is bringing our banks into contact with progressively leaner places and lower income-classes. Between 1926 and 1936, the deposits raised per place with banking facilities have fallen from 63 lakhs to 50 lakhs. This is a fall of about 21 per cent. The figures for earlier years confirm the same tendency to continuous diminution. Between the same years 1926-1936, deposits per branch for all banks taken together fell from 29.4 lakhs to 17·7 lakhs which means a fall of more than 39 per cent. The larger fall in the case of deposits per branch as compared with deposits per place is a mere re-statement in another form of our earlier conclusion that exploitation of existing banking towns attracts banks more than extension of activities to virgin fields.*

Of course, for reasons already indicated, this tendency to a progressive fall in resources available per place and per branch is not inherent in the present banking situation. The geographical and branch expansion of the Indian banking system is taking place in an unplanned and haphazard manner. The progress has not occurred in a consistent manner from places with larger banking potentialities to places with smaller banking potentialities. Large voids and lacunae are visible in many bankable parts of the country and until these areas are systematically surveyed and mapped out, our statistical evidence must lack finality.

This geographical and branch expansion has not the same significance for the different constituents of the banking system. In its great period of branch expansion, 1920-1930, the Imperial Bank of India actually improved its volume of resources per branch in an appreciable manner. Even in its period of quiescence after 1926, there

* Table II.

was a tendency to slight improvement. Taking figures in the large, however, it may be said that its volume of resources per branch has been maintained at about 45 to 47 lakhs.

Very much the same statement could be made about Exchange Banks. As recorded already, the years 1920-1930 saw a substantial fall in their deposit resources in India. But after the great loss of the initial years, they also seem to have settled down to a stable level of about 75 to 79 lakhs per branch.

Appreciably different has been the course of events with Indian joint stock banks. Between 1926 and 1930, they maintained their aggregate deposits stable only by a large creation of new banks and branches. In these four years, deposits per branch fell drastically from about 13 lakhs to 9 lakhs. The next six years recorded in an irregular manner a further fall to about 8½ lakhs. The fall is rather of a small order when we take into account the great impetus to expansion which marked these years. Nevertheless, the general drift is quite unmistakable.

The vast disparities in these figures of resources per banking office cannot but provoke some surprise. A bank has to justify itself ultimately by its ability to offer adequate services to the public in competition with its rivals and at the same time, earn profits normal to banking enterprise. Yet there are banks in India whose volume of resources per branch varies on the average within a wide range of 8½ to 75 lakhs and yet are able to satisfy their shareholders with soothing dividends. The inevitable inference is suggested that they represent either different types of organization or are engaged in different classes of business.

We must bear in mind that even this figure of 8½ lakhs per branch overstates the size of resources for the major part of these banks. For, these banks include the Big Five or Six whose deposits per branch varied in 1936 between 11 to 13 lakhs for the Indian and the Punjab National Banks and 106 lakhs for the Bank of India. It will be

shown presently that these big banks hold more than 3/4ths of the aggregate resources of Indian joint-stock banks. If they are omitted out of our present reckoning, the figure for the rest of the banks will probably fall to about 3½ lakhs. Yet, these banks are responsible for banking facilities in about 2/3rds of the places on the banking map of India, claim about ½ of the bank offices in the country and have improved their share of the aggregate deposits of the country from about 6 per cent. in 1930 to 11 per cent. in 1936. When Indian joint stock banks (class A & B) alone are considered, the proportion of deposits held by these small banks is seen to have risen from 19 per cent. in 1930 to about 36 per cent. in 1936.

That great disparities can exist in the volume of resources per branch without crippling the profits of banks or forcing them into questionable lines of business is amply proved by the discrepancies in the figures for the Imperial Bank of India and the Exchange Banks. The specialization of the latter in exchange business which earns relatively a low rate on invested funds and rigorous limitation of the former to the more lucrative short term business perhaps explain a large part of the apparent disparities. From the standpoint of organization also, it would be wrong to postulate the standard of equipment and maintenance of the bigger joint stock banks as the minimum suitable to this country. Many of them and certainly the Imperial Bank have yet to make efforts to adapt their technique, business methods and staff to the quality and size of business available in the smaller and leaner places in the country. This is well substantiated by the figures of their average expenditure per branch in a good year like 1936. The Bank of India leads with an expenditure of about 98 thousand Rupees per annum per branch and is followed by the Imperial Bank with a figure of about 82 thousand rupees. The Bank of Baroda and the Indian Bank which are located largely outside the bigger towns bring up the rear with an expenditure per branch of Rs. 25 thousand only.

On account of varying conditions of business, costs, etc., it is difficult to state the minimum resources which branches

on the average should have in order to assure sound lines of business and adequate profits to shareholders. To limit the range of our ideas on the subject, however, a calculation may be offered for banks which work under conditions typical of the biggest Indian banks. We may take as our basis the lowest average expenditure per branch incurred by Indian joint stock banks of the status of the Indian Bank or the Bank of Baroda, namely, Rs. 25 thousand. In the same year 1936, the highest rate of gross profits earned was 2·68 per cent. by the Imperial Bank of India. If banks in general could earn as high a rate as this, it would mean that a branch should have resources on the average of the order of 9 lakhs simply to meet the minimum expenditure postulated above. It is clear from this that with the best of management in the world and the most skilful technique of business, the previously ascertained figure of 3½ is regrettably small.*

That our calculation of a minimum of about 9 lakhs is somewhere in the neighbourhood of truth is corroborated by another piece of evidence. Of the 88 new branches, which the Imperial Bank of India opened by 1926, only 32 were working at a profit and 56 showed actual loss. Deposits at these branches of all kinds aggregated to 835 lakhs. In other words, acquisition on an average of about 9 to 10 lakhs per branch showed a loss on the bulk of the branches.†

The situation in the case of smaller banks is partially mitigated by their capital and reserves which bear a much higher proportion to deposits than in the case of the bigger banks. With many of them, the bulk of their resources is derived from their own funds.‡

* For a branch in Bombay which collects deposits of about 25 lakhs and invests about 65 to 70 lakhs of the bank's funds and which has a staff of about 25 persons, the expenditure per month may be about Rs. 8,000. For a branch in a small place of about 50,000 souls which is mainly a deposit-collecting agency, the expenditure per month may be about Rs. 800. In a place like Nagpur, a branch with a staff of about 6 persons spends about Rs. 900 and with deposits of 5½ to 6 lakhs is just able to meet the expenditure. See foot-note pp. 226; 351.

† Q. 9648-51; Appendix p. 479. Table 15th; Q. 12271. Minutes of Evidence. Hilton Young Commission. According to the third Schedule of the Reserve Bank of India Act 1934, the Imperial Bank is to receive in consideration of the maintenance of these branches 9, 6 and 4 lakhs per annum for three successive periods of 5 years each from the Reserve Bank of India.

‡ See pp. 140-47.

Degree of Concentration

Although small banks hold in exclusive possession about 2/3rds of the banking map of India and own at least half the total number of branches, the Indian banking system as a whole is a highly concentrated one. Till very recently, the Imperial Bank of India, 18 Exchange Banks and the Big Five of Indian joint-stock banks held among them 90 per cent. of the deposit resources of the country. In the last few years, the percentage has declined to about 87. If we add the Indian Bank and the Bank of Mysore to the list, the percentages for the years 1930 and 1936 are 94 and 89. Having regard to the area and the special political and social conditions of the country, few countries in the world could show a higher degree of concentration.

If Indian joint-stock banks are regarded as a special and peculiar credit-structure by itself—and for certain purposes, such a procedure is justified,—the degree of concentration appears much less. By 1930, the share of the Big Five in the aggregate banking power of Indian joint-stock banks rose to about 75 per cent. and of the Big Seven to about 80 per cent. The corresponding figures for 1936 record a decline to 68 and 73 per cent. respectively.*

Causes of Concentration

Such concentration is inherent in the necessities of the banking business itself. The fate of an ordinary enterprise is linked to the market prospects and fluctuations of one commodity or at the most, a group of commodities. Banks whose resources are withdrawable on demand cannot allow themselves to be caught in a stagnation or collapse of any particular market or allied markets. Self-preservation continuously goads them into interest in and relations with varied lines of trade and commerce. Such diversification of risks pre-supposes large resources and large clientele which can be secured only by exploitation of new territories. High speculation of certain areas in certain agricultural products, concentration of financial requirements of different areas at different times of the year, confinement of manufactures to certain narrow belts and areas of the

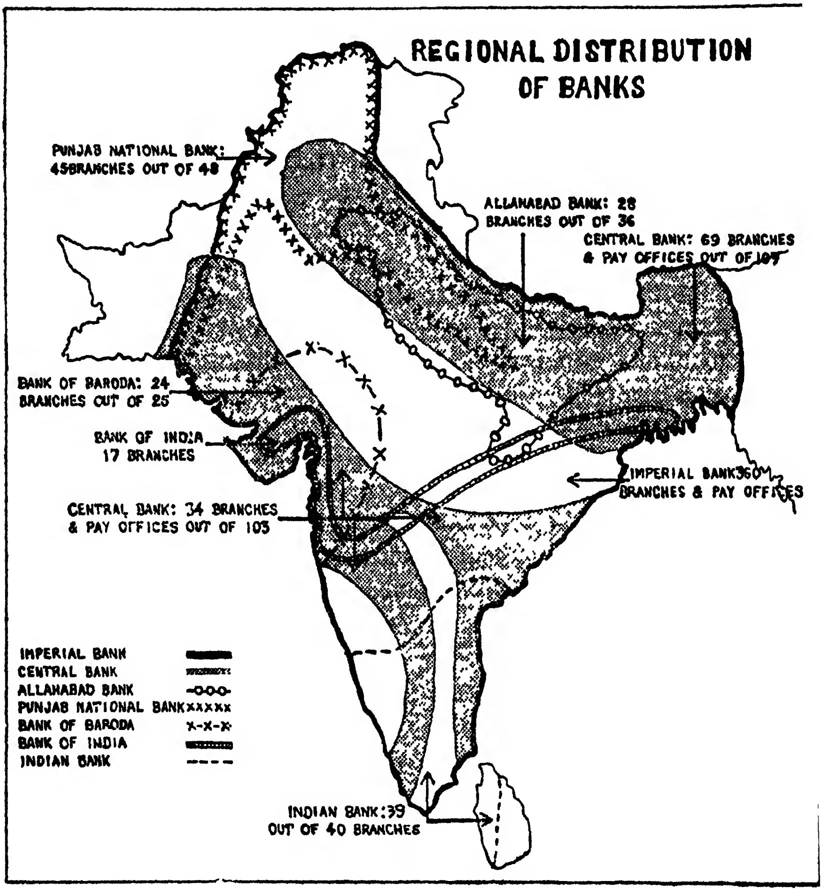
* Table V.

country, these have no doubt influenced and impelled the growth of certain banks.

(2) Inequalities of interest-rates are another factor causing territorial expansion. Even in small countries, rates are apt to vary from area to area according as these are agricultural, manufacturing, etc. In vast countries like India, territorial divisions are much sharper and differentials in rates very wide. As analysed elsewhere,* interest-rates are the highest in Madras and South India generally and quite high in the Indus and Gangetic plains. In the triangle roughly dilimited by Bombay, Ahmedabad and Calcutta, which represents the manufacturing and high finance area of the country, rates are comparatively low. To the impelling motive to diversify risks are thus added tempting opportunities of earning high rates. Cyclical or transitional changes which cause precipitous declines in interest rates are apt to make such an impulse to exploit higher rates almost irresistible. The years since 1929-30 illustrate such times when interest-rates in certain areas and particularly in big towns have fallen to persistent, low levels. Whether this impulse acts slowly or in great spurts, it does not exhaust itself till rates have been brought down to more or less common levels.

The third factor which tends in the same direction is the force of mutual competition among banks. Fears raised by the growth of rival banks are very frequently the cause of general movements for expansion whether by means of new branches or amalgamations. Much of the rapid expansion of branches and places which took place between 1921 and 1930 when the Imperial Bank was creating its 100 statutary branches was of this character. Many of the leading banks seem to have been seized with the fear that they might lag far behind in the volume of their resources and therefore suffer from the powerful competition of the Imperial Bank. Such competition redounds to the benefit of the country so long as it has to reach its full banking development. But many times, competition forces expansion beyond the point of economic

* See pp. 69-70.


REGIONAL DISTRIBUTION OF BANKS
PUNJAB NATIONAL BANK: 45 BRANCHES OUT OF 48
ALLAHABAD BANK: 28 BRANCHES OUT OF 36
CENTRAL BANK: 69 BRANCHES & PAY OFFICES OUT OF 103
BANK OF BARODA: 24 BRANCHES OUT OF 25
BANK OF INDIA 17 BRANCHES
IMPERIAL BANK 360 BRANCHES & PAY OFFICES
CENTRAL BANK: 34 BRANCHES & PAY OFFICES OUT OF 103
IMPERIAL BANK
CENTRAL BANK
ALLAHABAD BANK -O-O-O-
PUNJAB NATIONAL BANK xxxxx
BANK OF BARODA x-x-x
BANK OF INDIA
INDIAN BANK ----
INDIAN BANK: 39 OUT OF 40 BRANCHES

justifiability and burdens the country with too many branches, over-centralization, concentration of money-power, high cost of finance, etc. The expense ratios of our banks analysed elsewhere do not indicate that we are in the remote neighbourhood even of this state.*

Diffusion and Regionalization of Indian Banking Structure

On the other side, there are forces which thwart, though they cannot ultimately defeat, the movement towards concentration.

We have noted a while ago the diversity of interest-rates prevailing in different areas of the country. A bank which creates branches in different parts may invite embarrassment if it offers markedly different deposit rates from one branch to another. Branches with lower interest-rates run the risk of being denuded of their deposits while those with higher deposit rates may have to cope with a flood. Banks are protected to an extent from this difficulty by the ruling of law-courts that deposits maintained at one branch are not payable as a matter of right at other branches. They protect themselves also by establishing their higher deposit-rates not too high and contenting themselves with business high in quality and for that reason not too lucrative. The local banks are thus left with business whose high profitability goes well with high deposit-rates.

In few parts of the world perhaps do personal contacts, informal procedure, even oral obligations play a greater part than in India. A highly concentrated banking system is too impersonal to meet requirements of this kind. The local branch is more or less subjected to detailed regulations from head-quarters, procedure and security are necessarily documentary, and the spirit of legal forms broods over everything. A local bank on the other hand offers advantages which the wide-flung organisation of a bank with hundreds of branches cannot emulate. To all this, we

* Inequalities of seasonal requirements and more permanent inequalities of demand and supply of capital are well illustrated by following figures. March is a slack month for borrowing in Bengal but the slackness explains only a small part of the discrepancy.

Imperial Bank (Bengal Circle; last week, March 1925) Percentage of Bengal circle to All-India figures. Current and fixed accounts 54%. Bills, Cash credits, Overdrafts, Loans 87%.

Surplus branches and deficit, or borrowing branches are determined according to location e.g. Bengal, Madras, Punjab circles, etc. represent the former type. Sometimes two banks present a different picture in the same place.

must add special types of business peculiar to each locality with which the local bank has obvious advantages in dealing.

Amalgamation which in most countries has been the chief instrument of concentration has also to run the gauntlet of certain special difficulties in this country. Like all other institutions, banks also tend to become the mustering centres of all communal, sectional and even family interests. These are apt to rise in arms with destructive power and resourcefulness against any movement which threatens to diminish their importance.

Running athwart all these forces is the cross-current of Native State territories. As observed already, British India banks are loth to place their interests under the protection of Native Princes. Native State banks themselves avoid on their part such common interests. The upshot is independent local banks for different states.

These factors have demonstrated their power in more recent years. We have already noted the speed with which small local banks have sprung into existence or have exploited opportunities to expand themselves. Banks with capital and reserves of 5 lakhs and over have increased from 30 in 1930 to 42 in 1936 while those with capital and reserves between 1 to 5 lakhs have increased from 57 to 74.

These very factors have operated to give some of the bigger banks even strongly regional character. As the map facing page 31 vividly brings out, the Punjab National Bank, the Allahabad Bank of India, the Bank of India, the Bank of Baroda, the Indian Bank and the Mysore Bank have their operations concentrated in certain well-defined regions of the country. The Bank of Baroda and the Mysore Bank are most active within the territories of their respective states. The Indian Bank works in the special conditions of South India among a clientele largely composed of the Nattukottai Chetties. The narrow area covering chiefly the Bombay Province served by the Bank of India is the outcome of deliberate policy to adhere to the biggest industrial and commercial centres of the land.

The Punjab National and Allahabad Banks have always been the banks primarily of North-West India. Overshadowing all of them and competing with them almost everywhere are the Imperial Bank of India and the Central Bank of India the former under the pressure and inducement of special government patronage and concessions, the latter out of a will and spirit to expand. The Imperial Bank was a factor to reckon with between 1920-30, while the Central Bank has been most aggressive after 1930. The marked stationariness of some of the regional banks, notably the Punjab National and Allahabad Banks may be due in large measure to their loss of more liquid business in favour of these two great rivals.

International Comparisons of Banking Progress

The following table sets forth some broad facts to illustrate the progress of banking in India and elsewhere.

1936 OR NEAREST YEAR

	India	England and Wales	France (Principal Banks)	Germany	Switzerland	U.S.A
Density of Population	127	685	197	367	255	37·2
Square Miles per Banking Office ...	1392	5·79	102·7	...	...	242·6
Population per Banking Office ...	276000	3900	20000	...	1333	7900
Population in places with 5000 and over per branch...	39000	...	...	...	...	...
Population in places with 1000 and over per branch	189000	...	...	...	...	...
Deposits per head (Shillings) ...	(Rs.) 7·0	1164	165	212	275	1317
Deposits per head in places with population of 5000 and above ...	(Rs.) 45·5		...	...	...	...

Today, the deposit per head in India is a little over 10 shillings as against 212 in Germany, 217 in Switzerland, 1,164 in England and 1,317 in the United States.

It is obvious that the smallness of our per head deposit reflects more the lack of banking facilities than the poverty of the country. The figures of population and number of square miles per banking office bring this out quite clearly.

Less than one quarter of towns with population of 5,000 and over have banking facilities at present. If per head deposit is calculated for these places only, the figure is

in the neighbourhood of 70 shillings. Even then, the figure is about 1/4th of Switzerland and 1/3rd of Germany. The backwardness of banking habit and the low levels of income in this country must be set down as the next cause in order of magnitude.

Countries with high densities of population find development of banking facilities naturally easy. But densities are relevant only when they indicate degrees of urbanization. The United States have a density of 1/5th that of India only while France has a density much higher than that of India. Yet their population per banking office is about 8,000 for the United States and 20,000 for France. The figure for India is 276 thousand per banking office.

Other Banks

The banking structure and banking facilities which form the basis of our analysis in this chapter refer only to the banks which have a paid-up capital and reserve of 1 lakh and more. They exist, however, against a vast background of indigenous credit institutions and small banks which in their territorial extent and their aggregate financial operations over-shadow by far modern banking in this country. Money-lenders and indigenous bankers still continue to be the backbone of all agricultural finance.* On account of the deficiencies of law before 1936, the total number of companies which call themselves "banks" is far above the number of banks mentioned just now. Taking British India and Native States together, more than 2,300 companies returned themselves in 1936-37 as "banking and loan companies." Of these about 110 only are accounted for by the banks we have mentioned above. The rest aggregating to more than 2,200 are "banking and loan companies" with a paid-up capital and reserve of less than Rs. 1 lakh. It would be an error to underestimate their aggregate financial importance to this country. Their paid-up capital appears to be equal if not indeed definitely in excess of the scheduled banks and Indian joint-stock banks of class B.

The distribution of these "banking and loan companies" according to provinces gives us an unmistakable clue to

* Pp. 177-81.

what they really represent in our financial organization. About 1,200 of them are located in the province of Bengal and Madras accommodates about 500 of them. Bengal is the well-known breeding ground of what are known as "loan offices" and has contributed little by way of modern banks. Madras is the home of those ancient but queer Nidhis or Chit funds and has shown a peculiar genius for a prolific output of tiny banks. Whatever their usefulness in the economic life of the country, most of such companies do not satisfy the prime test of banking business, the acceptance of deposits withdrawable by cheque.*

According to figures compiled by the Reserve Bank of India for December 1938, the number of non-scheduled "banks" *i.e.*, banks with capital and reserves of less than Rs. 5 lakhs, is about 1,421. As may be surmised from the distribution of banking and loan companies referred to above, the bulk of these banks is concentrated in Bengal (988) and Madras (252). Among them all, companies which are banks in the sense that they accept deposits withdrawable by cheque and which conform to the obligation under Section L of the Indian Companies Act to submit cash reserve returns, aggregate to about 626 only. If we deduct from this figure the number of Class B banks, we arrive at about 500 and odd concerns as non-scheduled banks with capital and reserves of less than Rs. 1 lakh.

* 1936-37 (Rs. in Lakhs).

	No.	Pd.-Capital.	Reserve.	Total.
Banking and Loan Companies	2,342	3,221	...	......
Class A Banks	42	848	546	1,395
Class B Banks	74	100	55	156

Loan and Banking Companies.

Madras ...	451	Punjab ...	79
Bombay ...	86	Burma ...	22
Sind ...	33	Bihar ...	12
Bengal ...	1,173	Orissa ...	4
Assam ...	67	C. P. ...	6
U. P. ...	58	N. W. F. P. ...	3

TABLE I (Figures in lakhs)

	Imperial Bank of India (or Presidency Banks)			Exchange Banks.		Indian Jt.-Stock Banks A Class		Indian Jt.-Stock Banks B Class.		
	Paid-up Capital and Reserve.	Public Deposits.	Private Deposits.	Paid-up Capital and Reserve (m.£)	Deposits in India.	Paid-up Capital and Reserve.	Deposits.	Paid-up Capital and Reserve.	Deposits.	TotalDeposits (private) 3+5+7+9 (crs.)
1870 ...	861	548	689	2.1	52	11	14	...	...	...
1880 ...	405	291	849	8.0	889	21	68	...	...	...
1890 ...	447	859	859	8.0	758	51	210	...	...	...
1900 ...	559	280	1288	15.7	1050	127	807	...	...	...
1905 ...	628	811	2226	22.4	1704	162	1198	...	...	...
1906 ...	640	807	2745	24.8	1808	190	1155	...	...	...
1907 ...	655	885	2811	26.0	1917	292	1400	...	...	...
1908 ...	669	825	2861	25.8	1951	808	1626	...	...	...
1909 ...	678	819	8265	80.1	2479	854	2049	...	...	...
1910 ...	691	428	8284	84.8	2816	876	2562	...	...	...
1911 ...	700	488	8419	85.6	2816	412	2529	...	...	...
1912 ...	788	427	8548	87.6	2958	426	2725	...	...	...
1913 ...	748	588	8648	87.8	8103	864	2259	50	151	91
1914 ...	764	561	4004	86.9	8014	898	1710	55	126	88
1915 ...	747	488	8861	86.8	8854	488	1787	55	91	89
1916 ...	785	520	4470	87.9	8808	461	2471	68	101	108
1917 ...	742	771	6771	82.7	5887	466	8177	54	99	158
1918 ...	719	864	5097	89.4	6185	602	4059	68	155	154
1919 ...	782	772	6821	58.0	7486	768	5899	74	228	211
1920 ...	752	902	7801	90.2	7480	1092	7114	81	288	285
1921 ...	976	680	6577	111.6	7519	1289	7689	100	826	227
1922 ...	995	1415	5700	112.2	7888	1068	6168	110	887	209
1923 ...	1017	856	7419	140.0	6848	978	4442	111	826	198
1924 ...	1042	750	7671	180.4	7068	1070	5250	108	269	210
1925 ...	1055	546	7788	188.8	7054	1059	5449	118	841	211
1926 ...	1072	645	7889	147.9	7158	1084	5961	125	847	215
1927 ...	1086	720	7207	180.8	6885	1108	6084	122	845	212
1928 ...	1101	795	7180	187.9	7118	1109	6285	119	849	216
1929 ...	1110	760	7164	227.6	6665	1153	6272	115	857	204
1930 ...	1115	786	7660	198.6	6811	1190	6825	141	489	212
1931 ...	1062	882	6885	......	6747	1208	6226	128	892	197
1932 ...	1079	706	6836	...	7806	1221	7284	129	892	217
1933 ...	1064	644	7412	...	7078	1284	7167	181	474	221
1934 ...	1097	672	7427	...	7189	1267	7677	149	511	227
1935 ...	1109	...	7909	...	7618	1820	8445	150	544	245
1936 ...	1112	...	7879	...	7508	1895	9814	156	522	257
1937 ...	1112	...	...	...	...	...	...	...	...	...
1938 ...	1117	...	...	...	...	...	...	...	...	...

Cheque Clearances*

	Total clearances (crores)	Corrected for price-charges.	Index Number.
1914 ...	588	588	100
1915 ...	563	508	98
1916 ...	809	682	117
1917 ...	901	621	115
1918 ...	1396	784	145
1919 ...	1801	919	170
1920 ...	8145	1565	290
1921 ...	2024	1135	211
1922 ...	2022	1148	218
1923 ...	1856	1079	200
1924 ...	1778	1028	191
1925 ...	1770	1118	207
1926 ...	1592	1076	200
1927 ...	1649	1114	207
1928 ...	1857	1281	238
1929 ...	2088	1445	268
1930 ...	1804	1555	289
1931 ...	1561	1626	309
1932 ...	1577	1738	322
1933 ...	1620	1862	346
1934 ...	1708	1919	356
1935 ...	1860	2044	380

* Journal of Royal Statistical Society, Part III, 1937. P. 381-88.

TABLE II.

	Number of places with one bank office or more.	Total number of branches.	No. of brs. or offices at Lahore Delhi, Amritsar, Lucknow Cawnpore	No. of branches or offices at Bombay, Calcutta, Madras, Rangoon.	Imperial Bank branches.	Exchange Bank Branches	Indian Joint-Stock Bank (A and B) Branches.	Deposits per Office or Branch (Lakhs). Imperial Bank.	Exchange Bank.	Indian Joint Stock Banks (A and B)	Deposits per Place (Lakhs)	Branches per Place.	Deposits per branch. (Lakhs).
1916	140	338	57	54	...	...	228	...	...	...	...	2.47	25.5
1920	185	536	60	96	69	...	...	...	...	...	127	2.89	43.8
1921	207	...	...	...	...	...	...	...	...	...	94	...	29.4
1926	339	730	...	...	169	67	484	44	93	13.0	68	2.15	...
1930	393	938	67	94	164	88	683	47	77	9.8	54	2.38	23.0
1934	478	1269	...	...	163	98	1008	45	79	8.1	...	...	...
1936	514	1450	80	189	166	99	1185	47	76	8.7	50	2.82	18.1

TABLE III.

Places with Banking-facilities according to Population.

	Total number of Places analysed.	Below 5000	5000 to 10,000	10,000 to 20,000	20,000 to 30,000	30,000 to 40,000	40,000 to 50,000	50,000 to 75,000	75,000 to 100,000	1,00,000 to 2,50,000	2,50,000 to 5,00,000	5 lakhs and over.
1921	198	21	17	38	23	19	14	28	9	22	4	3
As Percentage of Total number i.e. 198		10.6	8.5	19.2	11.6	9.6	7 0	14.1	4.5	11.1	2.0	1.5
1936	507	126	60	91	72	35	35	36	15	27	7	3
As Percentage of Total number i.e. 507		24.8	11.8	17.9	14.2	6.9	6.9	7.1	2.9	5.3	1.4	0.6
1936 Big Six	194	87			32	22	22	31	15	32		3
1936 Imperial Bank	156	22			18	17	22	28	14	32		3

TABLE IV.

Branches of Big Seven Distributed according to Population of Places. 1936

	Below 20,000	20,000 to 30,000	30,000 to 40,000	40,000 to 50,000	50,000 to 75,000	75,000 to 1,00,000	1 lakh to 2 lakhs	2 lakhs to 3 lakhs	3 lakhs to 4 lakhs	4 lakhs to 5 lakhs	5 lakhs and over	Total analysed	Total number of Places covered
Number	63	42	32	36	46	28	37	25	12	5	15	341	194
Percentage of Total	18.4	12.3	9.3	10.5	13.4	8.2	23.1				4.3	...	...

TABLE V.

		Total Private Deposits (lakhs)	Percentage of 1 held by Imperial Bank	Percentage of 1 held by Exchange Banks.	Percentage of 1 held by Indian Joint-Stock Bank (A & B)	Percentage of 1 held by Big five.	Percentage of 1 held by Big Seven.	Deposits of Indian Joint-Stock Banks (A & B) lakhs	Percentage of 7 held by Big five.	Percentage of 7 held by Big Seven.
1900	...	8145	40.9	33.3	25.6	...	...	807	28.9	...
1913	...	9168	40.0	34.0	26.0	...	...	...	...	...
1914	...	8728	45.8	33.2	21.0	10.5	...	1826	50.1	...
1920	...	226,28	34.4	33.2	32.4	...	...	7347	...	...
1926	...	295,09	...	...	...	28.1	...	...	...	...
1930	...	212,22	36.0	32.4	31.6	22.1	25.7	6751	74.6	80.3
1934	...	227,54	32.6	31.4	35.9	26.5	...	8188	72.7	...
1935	...	245,16	32.3	31.0	36.6	26.5	...	8969	72.3	...
1936	...	267,48	30.6	29.1	40.2	27.2	29.2	10864	67.7	72.8

CHAPTER III.

THE STRUCTURE OF INTEREST-RATES

RECENT monetary theory tends to look on money rates of interest as the chief dynamic factor in our economic system. Since rent and wages are more or less rigid elements in costs, and profits in the short run at least are only a residue or surplus, this significance ascribed to interest-rates is in one sense inevitable. No general agreement is visible however as to the exact process by which these changes in rates become effective. Difficulties start with the very distinction which is usually made between short-term and long-term rates. It is obvious that among the multiplicity of rates which prevail in a modern money and capital market, an average or typical rate to represent either of them can be nothing more than a tool of theoretical analysis. The border line which separates short and long rates is necessarily indeterminate and certainly less ascertainable than that which separates open-market rates from customer's rates. Further, differences arise when attempts are made to explain the exact manner in which changes in short rates react on the economic process. According to one view, sponsored notably by Hawtrey, changes in short rates are by themselves sufficient to start an economic phase. Hawtrey analyses how costs of different classes of businessmen are affected by a change in short rates and arrives at the conclusion that the sensitiveness of dealers in stocks to such changes is the starting point of those impulses which ultimately take shape as booms or depressions. The second view, originated by Wicksell and re-interpreted in various ways by Keynes, Hayek, etc., looks to the sympathetic effect of short rates on long rates for the initiation of economic changes. The essence of a phase lies for them in the bias created by such changes in the structure of production now in favour of capital-goods and now in favour of consumption-goods. Changes in long-term rates are in this view inter-related with changes in the structure

of production. An intermediate view seeks to explain economic transitions as due to the gaps which reveal themselves now and then between short and long rates. According as the gap is more or less tempting, vast funds on the border-line flow into either short or long investments, and without waiting for sympathetic reactions on long rates enlarge or narrow the volume of employment. This intermediate view has this common ground with the second view that it looks to an enlargement of the volume of long-term investment for enlargement of employment.†

It may well be that these differences are ultimately differences of emphasis only and do not mean unqualified unwillingness on the part of advocates of each view to concede some element of truth in favour of other views. In any case, it is clear that the organization of interest rates has a significance which goes far beyond the individual concern and interests of banks. Banks have indeed to work within the conditions set by interest-rates. But since commercial banks are the community's main repository of short-term capital and the central bank has the control of the cash-basis of the credit-structure, the banking system is also the most dominating influence on these rates. The exact degree to which the banking-system controls or is controlled by interest-rates must however depend on the character of fundamental forces determining the rates structure of each country. An attempt is therefore made in the succeeding pages to describe the rates structure as it exists in this country.

Relationship Between Short-Term and Long-Term Interest-Rates

Our first concern must be to examine the relationship such as it exists in this country between short-term and long-term interest-rates. Banks are mainly interested in short-term investments. But it is obvious that the relative levels of these rates have a direct bearing on their profits and therefore on their policies. We may distinguish here

* T. A. K. Grant—A Study in Post-War British Capital Market.

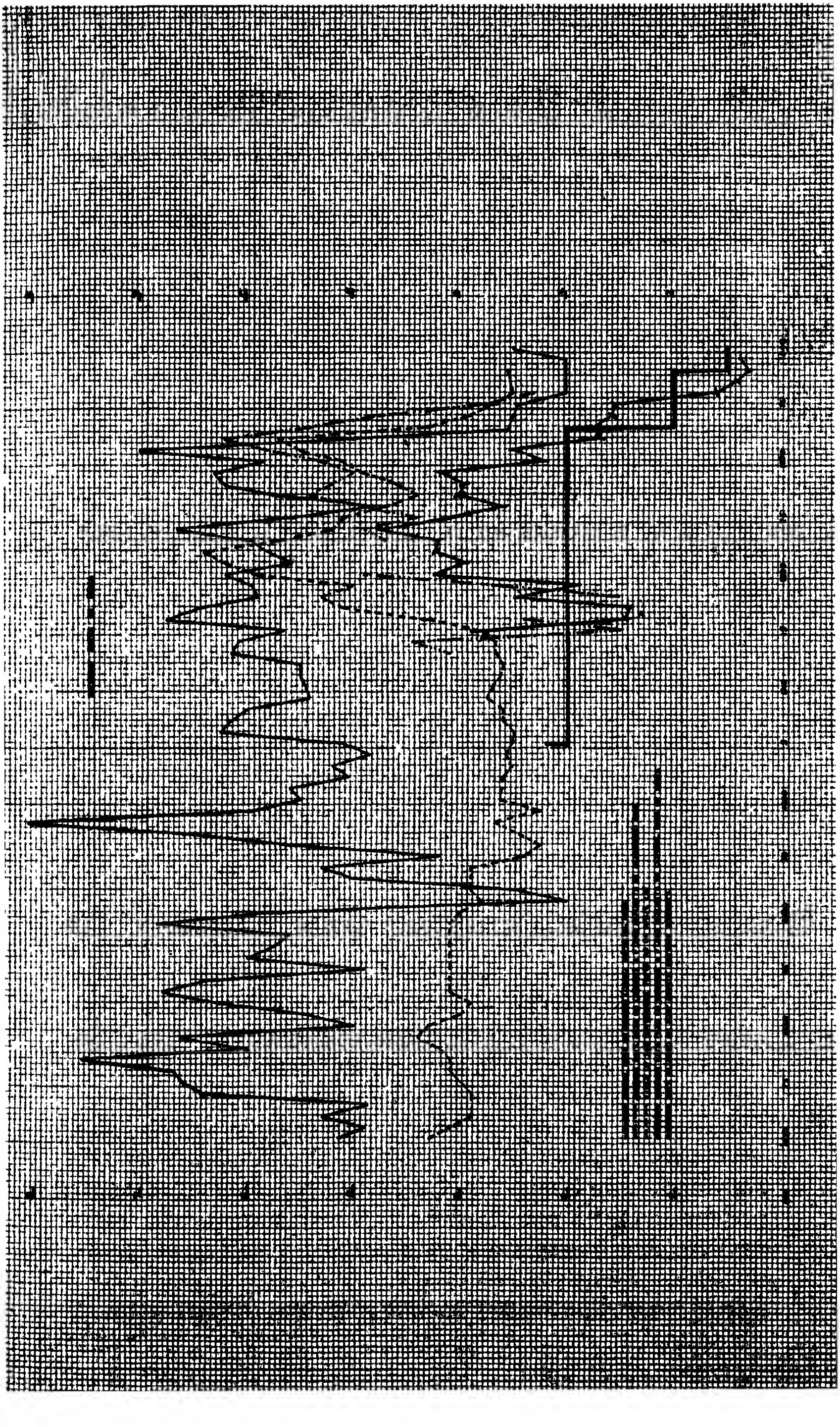
two questions which must be answered separately. In the first place, we must analyse those factors which decide that one class of rates should be higher or lower than the other. In the second place, the causes which determine whether the differentials between them shall be narrow or wide have to be ascertained.

The yield on debentures of large and well-established industrial concerns furnishes a reliable barometer of returns on long-term investments. Unfortunately, an index of that quality is not easily available for this country. In the absense of such statistics, we may fall back on the yield of 3½ per cent. government security as representative of the level of long-term rates. To a certain extent, the yield on government securities of this kind is indeed more akin to short rates than otherwise. The chief drawback of long-term investment, namely, non-availability of funds, is diminished to the very minimum since these scrips are highly marketable. Nevertheless, political factors which are inseparable from such investment and which make for an element of risk, and general psychological attitude and practices of the public which looks on them as an outlet for its permanent savings, make these securities a fair representative of long-term investments in general.

The rate of the Imperial Bank on demand loans represents *par excellence* earnings on short term investments which are free from risk and liquid in a high degree. As we shall see presently,* other open market rates conform more or less to this rate on demand loans, which, before the advent of the Reserve Bank, was also known as the bank-rate.

From our record of these rates in Table VI and the accompanying chart, the normal relationship between them appears to be that the short-term rate is generally, though not always, substantially above the long-term rate. For 30 years in the last century the excess amounted to more than 1 per cent. for 23 years and in years of difficulties like the seventies, it widened to as much as 2 per cent. There is a noticeable narrowing of the difference during the present century, particularly after the outbreak of the Great War.

* Pp. 65-69



There are a few exceptional periods, which by their very unusual character, serve to throw into bold relief the normal relationship. In 1891-92, 1921-22 and in the years which followed the crisis of 1929-30, the short-term rate actually fell below the long term. The significance of this reversal of what appears to be the more normal relationship for this country will be analysed in another place in this chapter.* In the meanwhile, it is important to note that in all ordinary circumstances relative cheapness or dearness of these rates expresses itself as a mere narrowing or widening of the margin between them. The years 1872, 1892, 1923, 1925, 1926 and 1930 are illustrative of this proposition.

This normal relationship between short and long rates in India is an arresting contrast to conditions obtaining in other countries. In England, the greatest international source and reservoir of short-term and long-term capital, the yield on consols or on high-grade industrial debentures shows itself consistently above short-term rates quoted for 3 months bank bills. It is difficut to say how far the long-term rate in England is raised by the annual outflow of capital and how far the short rate is lowered by the inflow of short-term capital from abroad for trade and investment purposes. It is more than probable, however, that even without the intervention of these factors, the relationship is expressive of the basic and permanent facts of British economic and financial structure.†

At the first glance, the United States appear to present a situation very similar to that in India. The rates for commercial paper of 60-90 days maturity have, on the whole, persisted in levels above the yield of Home Railway Debentures or Treasury Bonds of more than 8 years' maturity. But there are two special circumstances about this commercial paper which deprive the similarity of its apparent significance. In the first place, commercial paper in the United States does not represent any specific transaction and consequently any specific security of goods.

* Sec. III.

† "As a rule, although by no means always, short rates are below long rates......The true reason why short rates are usually below long is to be found partly in the structure of the market and partly in the extra risk of lending on long-term". P. 259, Economics, by F. Benham.

Secondly, commercial paper is a much less important outlet for investment of short-term banking funds than call and time loans to the Stock-Exchange. Call loan rates in the New York Market which are the true counterpart of short-rates in London tend on the whole to be much below the yield of Railway Debentures or Treasury Bonds. Between 1890 and 1911, call-loan rates shot above the yields of Railway Debentures and Treasury Bonds only in the years 1899, 1902, 1905-07.* It may be said therefore that in the United States also, the normal relationship is an excess of long rate over short.

The relationship between short and long rates is sometimes sought to be explained by means of an alleged distinction between money capital and real capital. The demand for short-term loans is according to this view essentially a demand for money-capital. The long-term rate represents the price which has to be paid for factors of production or real capital in general. Although divergences between the supply of money-capital and real capital occur now and then and have far-reaching consequences for the economic system, it is highly doubtful whether the distinction has any validity as a long period or secular phenomenon. The aggregate loan-capital of society, in the money sense arises because income-receivers, etc., prefer to hold a part of their money-income or money resources as deferred purchasing power. To the extent that they defer their claims on wealth, a stock of wealth composed of finished, half-finished and unfinished goods is diverted from direct consumption into further production. If a cross-section of economic society were obtained at any point of time, we should be able to see the two sides of the process at once—a disbursement of money-incomes equivalent to the net contribution of each factor to the creation of wealth and the existence of a stock of wealth in all inchoate or finished stages arising out of the fact that a part of the aggregate income of society is held back from consumption for short or long periods. An advance out of money-capital, however short or long its duration, means therefore a transfer of

* Pp. 242-246. Study of Interest-Rate, by Kock.

command over some portion of real wealth whether inchoate or in a finished condition. It is clear from this argument that short-term or long-term investments, differ only in the time-length of the advance and not in the kind or character of the resources which they enable the borrower to acquire. There is also no warrant except an empirical one, for the belief that short-period advances mean the creation of less durable goods while long-period advances mean an accretion of more durable goods. If the foregoing analysis is valid, then, a persistent relationship, as distinguished from cyclical movements, between short and long rates must be explained as much in terms of the supply and demand* of real wealth as in the case of any other economic price.†

I.

SOME HISTORICAL EPISODES

While the normal relationship in India is a level of short rates higher relatively to long rates, exceptional years or periods are not altogether absent. In 1891-92, 1921-22 and in the years following the great crisis of 1929-30, short rates actually fell below long.

Episode of the Nineties

Events in India in the closing decade of the last century have an unusual interest when studied in their international setting. The western world was then passing through what Keynes has described as "the famous and curious depression of eighteen-nineties." The curious character of the episode is intensified when European experience is compared with what transpired in India during the same time.‡

In one important particular, the situation in England and India was markedly similar. "The period (1890-96) was marked (in England) by an extreme abundance of gold and extreme ease of credit." The Bank of England

* Pp. 16-20; 20-22; "Study of Interest-Rates" Kock (P. S. King).

† See p. 95; ibid.

‡ Pp. 164-170. Vol. II. "Treatise on Money", Keynes.

rate was low and from February 1894 to September 1896, it stood at the unusual level of 2 per cent.*

In India, the short-term rates fell suddenly below the long-term in 1891 and 1892. In 1888, 1889 and 1890, the average rate of the Bank of Bengal was 5·460, 6·991 and 5·790. For 1891 and 1892, the average reached 3·062 and 3·4999. The rates of the Presidency Banks of Bombay and Madras recorded identical movements. Although the rates firmed up subsequently and rose above long rates, conditions continued on the whole easy from 1893 to 1896.†

This unusual ease of monetary conditions was the outcome of the fall in silver exchange and the incidental heavy imports of silver. For the 5 years, 1884 to 1889, the net imports of silver amounted to 44·6 crores but in the next five, they rose to 61 crores.‡

Most of this silver found its way into banks which used it to add to their cash or converted it into notes and coin. The highest point reached by "notes current" between 1875 and 1890 was 16·4 crores. But in 1891, this figure rose to 25 crores from the low level of 15·7 crores in 1890 and remained at 24 crores in 1892.

The introduction of the 5 Rupee note in 1891 explains only a part of the increase. The larger part of the increase occurred in 10,000 Rupee notes—the form in which banks usually hold their cash.¶

* Ibid. P. 165.

†

	Yield on Rupee Security.	Price of 3½ Govt. Security.	Rates of Banks of Bengal.	Bombay.	Madras.
1890	4.0	......	5.79	6.24	5.73
1891	3.8	......	3.06	3.05	2.92
1892	3.9	......	3.50	3.50	3.50
1893	3.0	......	4.88	4.90	5.27
1894	3.9	......	5.39	5.50	5.01
1895	3.4	......	4.33	3.93	4.26
1896	3.2	107-8	5.69	5.47	5.64
1897	3.4	100-8	7.92	7.87	7.98
1898	3.6	95-0	8.06	8.29	7.80
1899	3.4	101-2	9.91	9.88	6.05

Kemmerer in his Modern Currency Reforms pp. 66-67 fails to appreciate accurately the course of interest-rates due no doubt to the choice of wrong periods.

‡ Qs. 109-121, Appendices, Herschell Committee's Report.

¶ Amount of 10,000 Rs. Notes in Circulation (in crores.)

1887-88	2¼	1892-93	5 1/25
1888-89	2	1893-94	11 9/10
1889-90	1¾	1894-95	3½
1890-91	7¾	1895-96	...
1891-92	5 1/5	1896-97	3

Except for the extraordinary ease of monetary conditions, India presents a complete contrast to Great Britain. A boom in investment, particularly in foreign lending between 1888-90, had led to the Banking Crisis in 1890 and a collapse of investment activity thereafter till 1896.* In India, on the other hand, the fall in short-rates initiated a similar fall in long rates and paved the way to a well-marked investment boom. When the rate of the Bank of Bengal fell as low as 2 per cent. in 1891, there occurred an increase in the price of 3½ per cent. government security, or what is the same thing, a fall in their yield. In 1893, the premium on these securities varied between 3 to 4 rupees, in 1895, it reached 5 to 9 rupees, in 1896 the premium exceeded Rs. 10.

With the general fall in interest-rates, enterprise began to gather strength. From 1890 to 1893, the paid-up capital of joint-stock companies increased at a moderate speed. But thereafter till 1898, it mounted up at a rate which for those years was astonishing. The floatation of joint-stock enterprise was observed with surprise in contemporary business circles.†

In spite of a rising total of wages-bill, higher rates of money-wages and increase in other incomes, England experienced "trade . . . stagnant, employment bad and prices falling."‡ Between 1890-96, Sæurbeck's index-number fell by 18 per cent. and the Economist's by about 14.1 per cent. In the terminology of the Treatise, savings outran investment.

Things appeared otherwise in India. From 1881 to 1888 prices were on the whole stable—the index-number moving within a narrow range of 97-100. After 1888, however, in

* New Issues in England. (Annual Average).

1880-89	102
1889	163
1890	141
1891-96	76

† Paid-up Capital of Joint-Stock Companies. (In Lakhs)

1890	2,425	1896	3,115
1891	2,658	1897	3,312
1892	2,679	1898	3,519
1893	2,751	1899	2,860
1894	2,766	1900	2,470
1895	2,988		

See also Qs 2847-73; 3309-31; 3484-3500; 3478; Minutes of Evidence, Fowler Committee.

‡ Treatise.

sympathy with the fall of interest-rates and progress of investment boom, prices mounted up rapidly passing 117 to the 1896-97 famine level of 132.*

Keynes describes the British situation of eighteen-nineties as "a perfect example of a prolonged Commodity Deflation developing and persisting in spite of a great increase in the total volume of bank-money." In the light of the contrast presented by England and India, one may well wonder whether something more than interest-rates, saving and investment has not to be called in to explain the complicated train of events under observation.

This era of low short rates and long rates ended abruptly about 1897. The reversal of the trend of early nineties had been really initiated early in 1893, with the closing of the mints. But many adventitious causes delayed the logical consequences of the step. The supply of currency was actually enlarged as government accepted silver from banks and other parties who were likely to suffer loss by the new exchange policy. The Secretary of State insisted on rates for Council Bills much higher than market rates and his forced withdrawal from the field led only to large imports of silver as the only alternative means of payment. Subsequently, after two successive reductions in rates, he re-established touch with the market in January 1894 and released large quantities of rupees which had been impounded in government treasuries from June 1893 to January 1894.† The improvement in the exchange rate, in the meantime, tended to defeat itself by calling rupees out of hoards for the purchase of the apparently cheapening silver. The withdrawal of Government as the usual largest borrower in the market intensified the trend to lower rates.

By about 1897, however, the closure of the mints began to be effective. By 1897, interest-rates reached levels such as were never seen before except in the crisis year 1866. The Bank of Bengal pleaded lack of funds to make advances even against gilt-edged government securities and at

* Pp. 808-09; General Index. Number; "Currency and Prices" (Longmans)

† Sales of Council Bills. (m. Rs.)

1892-93	265
1893-94	157
1894-95	310

interest-rates as high as 18 per cent. Upcountry native firms were reported to be in difficulties or became actually insolvent. A significant feature of the situation was the greater stringency of funds in the banks than in the bazaar; bills for which the Bank of Bengal quoted 13½ per cent. were being dealt with in the bazaar at 8 per cent.*

The long-term rate was not slow in rising. The price of 3½ per cent. government security which had reached Rs. 110 in 1896 fell down to Rs. 103·8 in 1897 and still more precipitately to Rs. 93 in the following year.† Government intensified the situation by resumed borrowing—it borrowed 10 crores in 1896-99. Investment met an abrupt check. Paid-up capital of joint stock companies evaporated till for 1899 and 1900 it was lower than the pre-decade level even. The price-level was 117 in 1896 and 132 in 1897. It fell to 109 in 1898 and 99 in 1899.

The Great War and Post-war Years

The last years of the war recorded a noteworthy narrowing of the differential between short and long rate in India. The narrow margin ultimately gave way to an actual reversal of the relationship in 1921 and 1922. This time, the narrowing of the margin and its final reversal were caused not by any abundance of credit and short-term funds as in the last case but by the exceptional demand of government for savings of all kinds. In the years 1917-1919, the government borrowed Rs. 130 crores which in the circumstances of India was a colossal sum. The pressure of this demand and the growth of war investments forced up the long-term rate from its low level of 3·8 per cent. to 6·4 per cent. in 1922.‡

* Qs 5759-68; 8627-87; 8290 Minutes of Evidence; Fowler Committee's Report.

† Selling Price of 3½ p.c.

Securities.	Premium. + Discount.	
1894-95	+8- 1-0	to+4-14-0
1895-96	+5- 5-0	to+9- 1-0
1896-97	+10-4-0	to+0-14-0
1897-98	—0- 9-0	to—4-12-0
1898-99	—6- 6-0	to+1- 1-0
1899-00	+1- 0-0	to+4-12-0
1900-01	+2-11-0	to+5- 8-0

‡ Differential Between Average Rate of Presidency Banks and yield of 3½ per cent. Government Security.

1914			
1915	1·8	1921	—0·6
1916	2·4	1922	—0·5
1917	1·3	1923	0·2
1918	0·7	1924	1·4
1919	0·9	1925	0·5
1920	0·3		

Table VI.

The needs of war for which the Indian capital market was depleted of its resources were such that they had the effect of keeping the short-term rate relatively low. The funds raised by government were largely used for securing an increased supply of consumption goods and destruction-goods. In other words, long-term funds raised by government were restored to the producers as working capital to enable them to increase the supply of these goods. The production of capital or durable goods was much discouraged by the prevailing high rate and the deflection of demand from its usual channels. The working of these forces is well-reflected in the striking increase in the proportion of current to fixed deposits which marked war and post-war years.

Although this was the main factor, it was not the only one which tended to depress the short-term rate. When loans fell short of urgent needs of war and further taxation became inexpedient, government issued paper to cover its expenditure. Of the net deficit in revenues estimated for 1914 to 1920 at 36 crores by the Inchcape Committee the greater part was met in this manner. Since the aggregate pre-war cash balances of all Indian Banks were about 25 crores only, such an addition to the cash of the community was bound in the first instance to create an apparent plethora of cash with the banks and keep interest-rates low.

Despite the soaring prices of war-years, the percentage of cash to the deposit-liabilities of Indian banks reached record levels. In ordinary circumstances, unusual accumulations of cash occur either because of recall and non-renewal of loans or excess of payments-in over withdrawals. In times of great trade activity and business profits, however, such occurrences are out of the question. Nor could the high cash-balances be ascribed to the undoubted fall in investments, for, the void was replaced with loans and bills. The unusual growth in the liquidity of the banking system is explained by the creation of legal tender by Government in such a way that every rise in the price-level was a prelude to a fresh issue of currency notes.

The close of the war did not bring any diminution of pressure on the supplies of long-term capital. The years 1920-23 saw great investment in housing and joint-stock enterprise among others. Most of these concerns had been really initiated in the great boom of 1920 when the capital issues of joint-stock companies alone exceeded by more than 13 times the issue of the previous year which itself aggregated to a large figure. It is hardly strange that the long-term rate continued to mount up till 1923. Thereafter, with the decline of enterprise, the long rate began to decline.

The break of 1920 boom caused a slump in the bank-rate in 1921. The actual deflation of 1920 however seems to have caused no embarrassment to the banks or their customers. Although the sales of reverse councils effected a total contraction of 39·7 crores, the banks offset the pressure by allowing their inflated cash to fall to its more normal proportions. The rate of the Bank of Bengal was only ½ per cent. higher than in previous two years and the rate of the Bank of Bengal was a trifle higher. The upshot was that while rupees and notes were drawn out of circulation, the deposits of Presidency, Exchange and Indian joint-stock banks increased in the very same months by 23½ crores.*

But circumstances were conspiring to force up gradually the short rate and restore the usual relationship. Although banks avoided the deflation pressure, the bazaar rates could not escape it and rose to 8 to 11 per cent. as against 5 per cent. of the Presidency Banks. In 1922, 1923 and 1924, the Government were taking steps to force up the external value of the rupee to 1s. 6d. sterling. In 1922 Government sold no council bills and prices both in India and the United Kingdom were stable. From January 1923 to June 1924, Government sold council bills to a very limited extent and

* See Note by Sir C. Kisch Appendices to Hilton Young Commission.

(Figures in Crores)

	Capital Issues of Joint-Stock Companies. †	Paid-up Capital of Joint-Stock Companies.	Post Office Savings and Cash Certificate.	Prices Calcutta
1918	121.2	106	......	......
1919	281.7	122	......	208
1920	148.0	164	......	188
1921	80.8	227	......	181
1922	34.4	258	26	176
1923	26.2	244	33	177
1924	21.2	275	35	161

† Official years.

prices actually fell in India while they rose in England. From July 1924 to March 1925, prices in India kept pace with the deflationary policy of the Return to the Gold Standard in the United Kingdom. The Reports of the Currency Controller for the years 1922, 1923 and 1924 bear ample testimony to the stringency which developed and caused the average rate of the Imperial Bank of India to mount up progressively from 5·57 in 1921 to 6·68 in 1924.

The Aftermath of the Great Depression

The years 1923 to 1929 were years of normal conditions and prosperity in India. Although the yield of 3½ per cent. government security fell at first till 1927 and then gradually rose, the ordinary excess of short rates above long continued in the usual manner. The Imperial Bank was content to maintain its investments at a low but slowly rising level of about 20 per cent. and allow its cash balances to fluctuate enormously according to the course of the seasons. The Indian joint-stock banks followed a different course. The low level of war time investments was quickly raised to 34-36 per cent. while cash and loans were stabilised round 11 and 55 per cent. of deposit liabilities.

The disastrous effect of the great depression on agricultural prices, the fall in the value of Indian exports and weakness in exchange, contraction of currency in 2 years of 43 crores and growing internal political instability were creating a difficult situation just before England abandoned the gold standard and the rupee was linked to sterling. The short rates were rising very sharply in the early part of 1931 and the long-rate was mounting all through 1930-32. The currency measures of September changed the situation in a dramatic manner. The deflationary pressure ceased, agricultural prices were stable at first and then improved, exports of gold in so far as their equivalent was not hoarded relieved the pressure on monetary supplies. But the depression continued to deepen for some time longer.

The bills and advances of the Imperial Bank collapsed from about 51 per cent. in 1931 to about 23 per cent. in 1935. It met the onset of rising cash balances by raising its investments from less than 25 per cent. to more than 50 per cent.

The joint-stock banks whose participation in seasonal loans is much more limited passed through a similar phase, though not on the same scale. The ratio of bills and loans of the Big Five fell from about 55 per cent. to about 45 per cent. They distributed the inflowing funds somewhat equally between cash and investment, cash rising from less than 15 per cent. to 20 per cent. and investments from about 35 per cent. to about 40 per cent.

As the trade demand for loans fell, at least in money value, short rates collapsed from their high level of 1931 and from 1933 onwards sank below the long-term rate. The latter also fell though in a more slow manner. The post 1933 years are an epoch in the history of interest rates in India. Never before has the short rate persisted at levels markedly lower than the long rate for such a long period of time. Never before has it been maintained at one uniform level for such a long period and from season to season.

The years from 1931 onwards present a contrast to the episode of eighteen-nineties. In spite of a great and dramatic fall in interest-rates, recovery was slow and painful. On the industrial side, no investment boom such as we observe in the eighteen-nineties is visible till 1936 and when it did appear, it proved short-lived. New issues hardly improve till 1936 and the paid-up capital of joint-stock companies is almost stationary. The exception to this stagnation of investment is an outburst of house-building of astonishing magnitude which changed the appearance of almost every town in this country. Profits began to recover almost immediately from their record low level of 1931 but even in the recovery years 1934-35 they were far short of 1928 level. Agricultural prices stabilised themselves at their low depression level till 1935.

It is difficult to make any definite statement about the parallel course of savings. With the drastic fall of prices, the middle and lower urban classes which depend on wages and salaries certainly benefitted. The funds invested in postal savings and cash certificates, insurance, etc., which come largely from these classes record a striking growth.

Some of the agricultural classes even may have had surplus funds to invest out of the huge gold exports. Judging from the number of assessees to income-tax, it appears that out of the 18 classes into which they are divided, the top 8 classes show some decline in numbers while the lower ten classes are either stable or actually increase. On the whole, savings do not seem to have declined.

The striking difference between the nineties of the last century and the thirties of the present century is to be interpreted only in terms of the linking of the rupee to the sterling. This country was thus linked to the international depression also. With the silver rupee in the nineties, India had only her own weight to pull. In the thirties, India was only one member of a large team attempting to pull themselves out of an ever deepening morass.*

II

DIFFERENTIALS BETWEEN SHORT AND LONG RATES

It is more easy to account for the differentials between short and long rates than their relative position. These differentials must depend in the long run on the extent to which funds available for the two kinds of investments compete with each other. It is obvious that under appropriate conditions it is possible to finance long-term requirements with a series of short-term loans. The rationality of meeting short-term requirements with a long-term loan is not so immediately obvious. A long loan raised to finance short-term needs involves the inconvenience of holding idle cash-balances when the needs are satisfied. In certain circumstances, however, it may be economic to incur a long loan and place the balance as a fixed deposit, when the short-term needs are over. This happens when,

*	Capital Issues of Joint-Stock Companies.	Paid-up Capital of Joint-Stock Company.	Chain-Index of profits 1928-100	Max.min. index of share prices.	Cash-certificates and Postal Savings.	Prices Bombay-Calcutta; 1914-100.	Agricultural Prices. March-September 1914=100.
1928	21	278	100	101.9- 96.9	66	145	......
1929	28	296	78	101.4- 98.2	72	148	139—119
1930	67	282	47	95.6- 75.0	75	121	132—90
1931	29	285	27	74.5- 68.2	82	102	84—69
1932	30	284	34	58.1- 77.6	96	100	69—70
1933	30	300	44	81.4- 92.8	115	98	64—72
1934	36	306	62	95.5-120.2	128	92	77—74
1935	48	302	69	112.4-102.7	132	95	75—79
1936	109	...	65	105.8-127.0	...	94	88—86
1937	53	...	55	126.1-106.5	...	104	94—

although the rate on fixed deposit is less than the rate payable on the long-term loan, the payment to be made on short loans is so high that the excess more than counterbalances the loss on fixed deposit.* To the extent to which such substitution of long loans by short ones and vice versa is possible the rates payable on them must tend to hold close together. In ordinary circumstances, however, such substitution is impeded by certain costs and inconveniences which to that extent create margins between these rates.

(1) A series of short loans can replace a single long loan. But for the borrower, the renewal of a loan means expense and inconvenience from time to time. Besides, there is an element of uncertainty that short loans may not be forthcoming at the expected time, at the expected rate and in expected quantities. The borrower is willing for these reasons to offer a higher rate for a long loan.

(2) The preference for short or long loans is much influenced by anticipations about future course of interest-rates. When long rates are high but in course of time are expected to fall, financing by short loans is sought by borrowers as much as possible. Funding of existing short-term indebtedness is postponed—which means again diminished interest on long loans. This preference for short loans explains how in the ascending phase of the trade-cycle when rates are hardening, short-rates are apt as in recent years in Great Britain and the U. S. to mount above long rates. When the trade-cycle is reversed, the same factors depress short rates very much below long. In the case of India, as noticed already, these phases reveal themselves merely as narrowing or widening of the margins.

(3) The trouble and expense of repeated renewals have obviously no relevance to long loans. Periodic anticipations of changes in rates have also limited significance since a long loan takes account of every foreseeable factor over long periods—which indeed explains the relative stability of long rates. The factor which directly affects the long rate is the unavailability of invested funds and the risk of default, which grow with the length of the loan. In making

* Pp. 130-32. "Trade and Credit", by R. G. Hawtrey

a long loan, the lender has to take into account not merely the ability and character of the borrower but also probable economic changes and events which may affect the borrower's capacity to repay.

Besides these factors, investment habits and financial organisation of a country also decide the extent to which short and long loans are in direct competition. If commercial banks hold the bulk both of short-term and long-term savings of a country, short and long rates naturally tend to hold close together. In Sweden, for example, the small investor is not accustomed to invest directly in shares and bonds while the rich man is not able to find outlet for his temporary surpluses because of the non-existence of an open money-market. This situation is reflected in the fact that 80 per cent. of the deposits of banks consist of time and savings deposits while the balance is made up largely of special accounts withdrawable at 14 days' notice.* In India, on the other hand, investment in industries etc. is direct, which leaves the banks control largely over short-term funds. Thus, although the return on short loans tends to be higher, the reservoir of funds available for such investment is not directly replenished from supplies of long-term capital, and a deviation of short rates from long wider than what exists in Sweden is made possible.

The foregoing factors explain the limits within which short and long loans compete with each other for employment and the consequent margins which are established between them. They also suggest the line along which an explanation must be sought of the reversal in India of the normal relationship between the rates. The largest demand for employment of short-term funds in India arises from the needs of agriculture. But employment of funds for purposes of agriculture suffers from two drawbacks which entirely change its character. The risk of default is very high and compares unfavourably with the risk which may be incurred in long term investment in joint stock enterprise. Secondly, although the finance required may be short term in name, the proportion of renewals as a matter of course is so high

* Pp. 284-85. "Study of Interest-Rates", by Kock.

that the investment is inevitably looked on as long-term in essence. The high rates for what is in name only short term finance for agriculture react on other rates in agricultural areas and influence ultimately the situation in the organised money markets of the country. The attitude of the foreigner towards investment in India tends towards the same result. Foreign funds flow willingly into long term investment, lowering the long rate, but hold scrupulously aloof from short term investment—regarding India as a particularly unattractive market despite its high rates.

As a profit-making business, a bank is but a broker between persons who have funds to lend and others who wish to borrow. The margin between the borrowing and lending rates is the source of bank-profits. Ultimately, indeed, these rates depend on the supply and demand of capital and the state of trade and business confidence. But within the limits set by these general conditions, banks offer on their deposits as low rates and charge on their loans as high rates as are consistent with maximum profits. Under perfectly elastic and competitive conditions, the margin will correspond to the costs of banking business.

III

RATES PAID ON DEPOSITS*

Demand-Deposits.

In offering rates on deposits, banks have to take into account the volume of resources they wish to attract and can profitably invest. If this object is approached from the standpoint of the banking system as a whole, the offer of interest on demand or current deposits is either superfluous or not justified by any comparable advantage. Demand deposits are sought by the public more as a financial convenience than as profitable investment and as such their aggregate volume is little responsive to offer of interest-rates. The effect of these payments on banking policies is on the other hand generally undesirable. The necessity of earning interest puts banks under constant pressure to

* Interest-rates have been arrived at as explained in foot note ‡ p. 234 Ch. VII. Rates are of course never quoted in decimal fractions. But it is not possible to obtain past records and the choice lies between some indication of level and trend and no indication at all. In a certain sense and for certain purposes we are justified in regarding these calculated rates as the real effective rates.

make investments of some kind or another, even in times of slack trade and limited outlets. The evil of these rates was illustrated in the case of England by the crisis of 1857 but the banks waited till 1877 for a voluntary abolition of interest payments on current accounts. It was one of the many lessons learnt by the United States from the banking disaster of 1932-34 and a prohibition on such interest payment was embodied in the great banking laws of 1933 and 1935.

In India, Exchange Banks offer as a rule some interest on current deposits. The Imperial Bank of India does not allow any interest on current accounts. Indian Joint Stock Banks quote as a rule rates on current as well as fixed deposits. The offer of these rates appeals to them as a means to make headway or at least hold their ground against the prestige, power and size of foreign banks. It is quite probable that but for the attraction of interest on current accounts, a part of their resources would be diverted into Exchange Banks and the Imperial Bank. But it is a matter for grave consideration whether the practice is not a source of weakness to them in the long run. The absence of a market in call-loans and high quality bills aggravates this evil by making the less liquid investments a larger proportion of the whole.

We have no satisfactory, or abundant record of rates paid by Indian Joint-Stock Banks on current deposits. There is available however a record of the average rate paid on such deposits by the Central Bank of India.* The Central Bank may be said to represent conditions and policies which stand mid-way between the most orthodox and the unorthodox banking practices prevalent among these banks. Information relating to it is, for this reason, particularly instructive.

Till 1931, the Central Bank paid on demand deposits an average rate which varied between 2·01 to 2·53 per cent. In conformity with the course of interest-rates in general, the rate declined fast thereafter, reaching the record low level of ·77 per cent.

* Table VII

Its significance is made clearer when compared with other rates. Till the depression, this average rate of the Central Bank was generally only a little less than ½ the yield of 3½ per cent. Government security. After 1931, the rate dwindled to about 1/3rd and later to less than 1/4th even.

Equally significant is the gap maintained between fixed and current deposit-rates. Till 1933, a gap of about 2·7 to 3·7 was deemed necessary to prevent wholesale migration of funds from this category into the other. The gap then narrowed to about 1·5 per cent.—current rates falling more precipitately than fixed rates. These gaps by themselves are impressive. As the level of current deposit rates suggest, these gaps bespeak mainly the high levels which rates on fixed deposits are apt to reach.

Half the yield on 3½ per cent. government securities is rather a high inducement. It is possible only on account of the abundance of high earning assets in India and the paucity of liquid investments like call loans. From a long distance viewpoint, however, the presence of this feature in our banking system must be reckoned as a source of weakness and likely embarrassments.

Rates on Fixed Deposits.

Rates on fixed deposits partake of a different character altogether. According as their level is high or low, relatively to returns on other forms of investment, the volume of fixed deposits is apt to fluctuate in a very sensitive manner. Even as between fixed and current deposits, there is a minimum level below which the return on fixed deposits is felt hardly to compensate for the loss of availability, and conversion into current deposits is preferred to a certain extent. There is on the other hand another and a more direct criterion which the banker takes into account —the rates which he expects to charge his customers. The interaction of these two sets of rates, the rates on alternative forms of investment and the rates prevailing in the market for short-term accommodation gives the economic level for rates on fixed deposits.

From the stand point of the depositor the most direct alternative to fixed deposit is gilt-edged government securi-

ties, represented in England by the Consols, and in India by the 3½ per cent. securities. There can be of course no invariable relationship between the yield on fixed deposit and the yield on government securities. The state of business-activity, risk of depreciation of securities, the specific purposes for which deposits are to be held, etc.—these are factors which may create divergences between the two. Besides the direct influence of the long-term rate is naturally limited to those deposits which are fixed for longer periods. Between deposits which are impounded for short-periods like fourteen days or even one month and deposits which are fixed for 6 months or one year, no direct competition exists. In India, deposits for shorter periods than 6 months the so-called "short deposits" are usually accepted in the bigger places but the most common period for fixed deposits is one year. The proportion of long-period deposits is apt to be very high.

As for lending rates, these are represented in highly organised money-markets like those of London and New York by the bank-rates. A practice has therefore grown up of relating deposit-rates to the bank-rate as so many points below the latter. The other lending rates then fall automatically to their economic levels. The situation in India is materially different. The rate on demand-loans of the Imperial Bank represents broadly the minimum return obtainable on short-term accommodation in the highly developed financial centres of the country. The rates obtained by other banks vary enormously according to the localities they serve and the type of business they solicit.

Even in the slack season, rates as high as 10 to 11 per cent. could be reaped against wheat-pits in the twenties of the present centuries. When the monopoly of the bank in question was intruded on by another bank, the rate fell to 8 per cent. The appearance of the Imperial Bank brought it down to the civilised level of 6 per cent. What is more, the effects of these changes are felt far beyond the locality immediately concerned, a big, circumambient region of 100 miles being mentioned.*

* Minutes of Evidence; Hilton-Young Commission, Q. 12061; 12009. The place concerned was Harpur

Apart for disparities of economic conditions and state of competition from one tract to another, banks themselves have the choice between business and business in the same tract. There exist strong grounds for the surmise that our banks tend to concentrate on one-type of business or another according to the state of competition, etc. There are banks which find it profitable to lend money at rates almost the same as in England. But for others, such rates would be highly uneconomic.* The Imperial Bank has been found to quote 5 per cent. at a time when the Allahabad Bank could not have a profit-margin at less than 7½ per cent.† Thus, the Indian joint stock banks are not a homogeneous system but a group made up of several types whose common form of organisation conceals serious qualitative differences.

Hence, Indian joint-stock banks offer rates which are conspicuous for their large variations. Even in a country like England, deposit-rates in the short loans market of London and in the country reveal as large differentials as 1 to 1¾ per cent. In India, the differentials range much wider. 5 per cent. for one year, 6 per cent. two years, and so on at a time when the yield on 3½ per cent. security was no more than 3½ to 4 per cent.—these are by no means infrequent with certain types of banks. The effectiveness‡ of high rates to overcome the psychological resistance of the public cannot be doubted, either. In his evidence before the Chamberlain Commission, the Secretary of the Bank of Bengal amply testified to this fact. When the Bank raised its rate for 12 months from 3 to 4 per cent. as an experimental measure, the incoming flood of funds was so embarrassing that as a measure of self-protection, it promptly restored the old rate.¶ "Money is available in India" testified a banker twelve years later, "if the price is paid for it, and there is no more powerful agent for bringing hoards into fruitful employment than a good price for money."§ In fairness to the more reputable banks, it

* Q 10967-74; 12034; Minutes of Evidence, Chamberlain Commission.

† Q 11866-11870; Minutes of Evidence, Hilton-Young Commission

‡ Q 8668-8728; Minutes of Evidence, Chamberlain Commission.

¶ Minutes of Evidence Q 7950.

§ Appendices, Hilton-Young Commission; p. 509

must be recorded that they rarely accept fixed deposits for periods longer than one year.

The only continuous record for rates on fixed deposits we have got relates to the Central Bank of India. While the average rate paid by it on all deposits, current and fixed taken together, has been as a rule below the yield of 3½ per cent. securities, the rate on fixed deposits was above it by a margin of ·7 to 1 per cent. in the years of high interest-rates 1924-29. But after 1929, the fixed deposit rate fell below the yield of these securities and presumably, this was the case before the year 1923 also.*

Average Rate on all Deposits

Although we have no separate records for rates paid on fixed and current deposits except for the Central Bank of India, statistics for the average rate paid on both types of deposits taken together are more abundant. The average rate is useful as giving us a direct idea of the profitability of different assets of banks.

The Allahabad Bank which operates largely in the U.P. and a part of the Punjab paid a rate on the average which till 1925 was less than the yield of 3½ per cent. security. But thereafter, it seems to have been unable to reduce its deposit-rates in conformity with the rapid fall of interest-rates which took place. The average rate has been actually higher than the yield on the aforesaid security.

The Punjab National Bank which operates to an extent in the same area records a different state of things. The relationship between its average deposit rate and the yield on 3½ per cent. security was rather indefinite till 1929—the

* The rates offered and the changes in them made by the Indian Bank of Madras are set out in the following table :—

	Before 1910 and till 1917	1917		1926	1936	1940
Fixed Deposits—						
24 months	5	5½	6	4½	3	3
12 ,, ...	4½	5	5½	4½	2½	2½
9 ,, ...	4	...	...	...	not	not
6 ,, ...	3½	...	...	...	received	received
Religious and Charitable Deposits.	2 p.c. above the ordinary rates					
1 month minimum and notice of a fortnight	2½	...	...	...	...	,,
Current Account—minimum Daily balance of Rs. 100 (on Rs. 300)	2	...	...	...	1	1
Savings Account minimum Balance of Rs. 5. (Now Rs. 10) ...	4½	...	...	...	3—2½	2
Commission for purchase and sale of Government scrips	3/16	...	...	...	...	...

former fluctuating a little above or a little below the latter. After 1929, the average rate sank below that yield. Since the proportion of fixed deposits in the liabilities of the Punjab National Bank is higher than in the case of the Allahabad Bank, particularly in recent years, it is clear that the rates of the Allahabad Bank on fixed deposits tend to reach higher levels than those paid by the other bank.

The rates of both the Allahabad Bank and the Punjab National Bank are as a rule higher than those of the Central Bank of India.* After 1925, the differentials between them have widened in a marked manner.

After the Allahabad Bank and the Punjab National Bank, the highest deposit-rates are paid by the Indian Bank which operates largely in South India. Till 1933, its average rate which as a rule has been below the yield of 3½ per cent. government security stood between 3½ to 4 per cent. Afterwards, it fell much below that yield but continued to be quite as high as among important Indian joint stock banks. The margin between the rates of the Central Bank of India and the Indian Bank tends to be about 1 per cent. and has rarely fallen below ½ per cent. Even during recent years, the margin continues to be about the same.

We have no statistics available for certain important banks like the Imperial Bank, the Bank of India, the Bank of Baroda, etc. From our analysis of their profit and loss accounts and particularly their rates of gross and net profits, however, it can be confidently inferred that their rates are lower than those of the Central Bank of India.*

As we have indicated already, the significance of the average rate cannot be accurately appreciated without taking into account the proportions of fixed and current

* Cf. "The Punjab National Bank which is the only Indian Bank in Northern India with foreign connections is said to charge very high rates as compared with exchange banks in Bombay". P. 283 Banking Inquiry Committee Report 1931.

Deposit-Rates.

	Central Bank of India			Bank of India.			Imperial Bank of India.		
	Savings A/c.	Current A/c.	Fixed A/c.	Savings A/c.	Current A/c.	Fixed A/c.	Savings A/c.	Current A/c.	Fixed A/c.
1931	4	2	5	3½	2	4½	3½	...	3½
1932	3	1½	4	3	1½	4	2½	...	2½
1933	2½	1	3	2½	1	3	2	...	2
1934	2½	1	1	2½		2½	2½	...	2

deposits. These proportions vary markedly between bank and bank. The Punjab National Bank has as high a proportion of fixed deposits as 75 to 80 per cent. of the total. The Bank of India maintains it at about 50 to 55 per cent. A larger proportion of fixed deposits means a limited ability to earn profits and a corresponding temptation to launch into illiquid business.

Regulation of Deposit-Rates

Variations in deposit-rates from tract to tract and banks with one type of business to banks with other kinds of business are both inevitable and in conformity with the economic needs of India. But variations which arise from unhealthy competition among banks are a source of weakness to the banking system as a whole. Uneconomic rates offered by banks mean unavoidably unhealthy business and banking practices. Advanced banking systems recognise that unchecked competition in deposit rates advance the interests neither of individual banks nor of the banking system. The Federal Reserve Board in the United States, the Syndicate of Banks in Paris, the Stempelvereinigung in Germany, the informal association of the Big Five in England reach agreements from time to time as to deposit-rates which are strictly adhered to. Nothing will ensure the steady progress of banking in India more than some regulation of deposit-rates which is both effective and at the same time elastic enough to permit unimpeded the work of reaching all classes of potential depositors. A workable scheme would be to divide the country into a number of circles marked from each other by well-defined financial needs and characteristics. As in France, banks in each circle should voluntarily allot themselves to three or more classes according to their type of business and each class should have maximum rates which they must not exceed. The regulation need not seek to cover all classes of deposits. As in England where the agreed rates apply to deposits subject to 7 days' notice only, we might prescribe rates for the most common period of fixed deposits—which is usually one year.

Rates Earned on Investments

In examining the structure of rates charged to the public, we have perforce to exclude all rates for which continuous or reliable records are not available. A modern capital and money market presents two broad classes of rates, rates prevalent in the open market or open market rates and rates charged to customers. Even in more advanced countries, sufficient and reliable data for the latter class are not easily obtainable. It is no surprise then that the only statistics available in this country relate to open market rates.

The rates charged to customers by banks and particularly by other lenders should not, however, be underestimated as factors in the general banking and economic situation. Mortgage loans, it is to be presumed, absorb no small fraction of the annual savings seeking investment. In urban centres, loans against houses and sites, and in less industrialised places, loans against farms attract not a small share of banking and other funds. Loans for consumption whether direct, or indirect in the form of instalment credit, have an important place in most countries. The growth of institutions for financing instalment sales have tended in recent years to link these rates to the rates structure of each country. A more astonishing development has been the growth of "professional and private" loans in the aggregate advances of banks. No mean fraction of these loans consists of consumption loans, pure and simple.

Broadly speaking, the main factor distinguishing rates charged to customers from open market rates is that while differentials among the latter are much influenced by the period of the loan and the quality of the collateral offered as security, the differentials among the former are mainly determined by the presumed banker-customer relationship. Time is not an over-riding factor in customers' rates because the banker strives to retain his customer as a permanent client while the customer expects the banker to take into account not merely the profit on the particular loan but the present and future welfare of the business as

well. Renewals of these loans, whether given initially on a time or demand basis, is a common occurrence and practice. Security also is not of so much relevance since the banker seeks safety, not in any particular kind of collateral, but in a number of facts and factors which he has learnt to take into account as a result of long personal contacts and relationship. A customer is not merely an outlet for investment. In his capacity as depositor, he proves an important source of bank funds also.

Secondly, unlike open market rates which tend to approximate to a certain level, customers' rates are apt to show great geographical variations. Since local knowledge and contacts are the chief basis of these loans, local conditions influence rates which, even in countries like the United States, are apt to be twice as high in certain localities as in others.* The presence or absence of a local link with the central bank of the country, the abundance or paucity of capital indicated roughly by the volume of local deposits, the degree to which funds are attracted from smaller to bigger centres or vice versa, operating costs of banks relatively to the size of business—these are some of the important factors normally at work in determining the level of these geographical variations.

Open Market Rates

(1) The Imperial Bank's rate for demand loans may be taken as the barometer of returns on short-term capital in this country. The rate may be treated as representative of rates charged for cash-credits and ordinary loans as well. These forms of accommodation offer certain advantages which have reduced other forms of accommodation like discount of bills, etc., to insignificant proportions in the assets of Indian banks.†

(2) The Imperial Bank Hundi rate is the rate at which the bank discounts first class trade bills. Till 1935, the law restricted the maturity of these bills to 3 months. As

* P. 90. Table. Chapter VI. "Money Rates and Money Markets in the U. S.", by Riefler.
† Table VIII and footnote p. 348

a matter of practice, the maturity of bills discounted averaged to about 60 or 61 days.*

Since the bank can terminate a demand loan, usually with some notice, one should expect the hundi rate which is based on an assured investment for a certain period to be, if at all, above the rate on demand loans. As a matter of fact, the hundi rate, although it moves generally in sympathy with demand loan rate, is found to be sometimes above it or below it."$

(3) The call money rate is the rate for surplus money seeking investment for possibly a minimum period of 24 hours. Call money is repayable at the option of either lender or borrower. In London, call loans are given only on security. It is the practice in India to limit these loans to first class parties without demanding any security.†

Call money is used in India for purposes of dealings in the bullion markets and stock exchanges. It is probable that loans for stock exchange purposes are more important in Bombay than in Calcutta. Even in Bombay, the volume for these purposes does not reach more than a modest size.‡ Call money figures prominently in interbank loans.

Call money rates¶ move generally in sympathy with the rate for demand loans. They are apt to rise very high and on occasions, equal it even. In the busy season, call money is sometimes unavailable at any rate while in the slack season it falls below short deposit rates, losing all touch with the Imperial Bank rate for demand loans.

(4) Bazar Bill rates are the highest rates in the Indian money market. They are charged on bills which are discounted for small traders by shroffs. The rates are lower in Bombay than in Calcutta. This is probably due a closer association of shroffs with the banking system in Bombay than in Calcutta.§

* Q 9599. Minutes of Evidence, Hilton-Young Commission. Para, 578 Banking Inquiry Committee's Report.

$ Para, 580 Banking Inquiry Committee Report.

† Minutes of Evidence, Hilton-Young Commission (M. S. M. Gubbay Esq.) Qs 12598 to 12604. Para, 580. Banking Inquiry Committee Report.

‡ Para, 577 Banking Inquiry Committee Report.

¶ Table VIII.

§ Table VIII.

Our analysis suggests the conclusion that the only relationship which exists between different money rates in this country is such as arises out of basic economic facts like seasonal variations in demand, general shortage of capital, etc. There is no precise definiteness about their inter-relations such as exists in the advanced money markets of the world. The indefiniteness may be traceable to several causes: absence of a sense of common interests in the banking community, the lack of an effective central currency and credit authority, impediments in movements of capital, etc.

Agreement and convention among bankers regarding the articulation of rates have a very precise economic objective. Taking the bank-rate as representative of short rates in general, convention seeks to establish definite margins between different open market rates and thus eliminate the danger of unhealthy competition. The margins are not arbitrary but bear a fairly accurate relationship to the costs of different kinds of investments. The margin between deposit-rates and bank rate prevents any tendency to grab deposits and assures banks a margin of reward commensurate with their costs. The rates for bills and call loans are essentially rates for surplus funds or funds which are to be invested in such a manner that they are almost equivalent to cash. These rates tend to fall almost to the levels of deposit-rates with a bare margin sometimes for costs. From the standpoint of the control of the money market, the regulation of these rates is much more important than the definition of the relationship between the bank-rate and the deposit-rates. The bill market and stock exchanges into which these funds flow very largely are very sensitive to changes in interest-rates. The control of credit acquires quickness, momentum and effectiveness when exercised through these parts of the economic structure. Their ultimate effects on other parts of the structure are apt to be uncertain and at best tardy. As for advances, the tradition in London has been

a rate 1 per cent. above the bank-rate with a minimum of 5 per cent. in all circumstances.*

The absence of convention in India is perhaps best illustrated by the indefinite relationship between the Imperial Bank's rate for demand loans and its hundi rate. As the security behind a demand loan is as good as that supporting a trade bill, the demand loan rate should be a little lower if the average period of such loans falls short of 60 or 61 days or a little higher if the period tends to be longer. Actually, the rate is sometimes above and sometimes below the hundi rate. Such indefiniteness contributes an element of uncertainty as to the best lines along which credit instruments and practices could develop.

Call loans are prized abroad because they serve as a second line of protection after cash. Rates in a market like London are fixed in a definite relationship to the bank-rate because if loans are not forthcoming from commercial banks, the bill market can always turn to the Bank of England for discount at its rate. In India, call loans are essentially loans out of surplus funds in which large variations occur according to seasonal tightness or slackness. The only alternative to call loans is maintenance of larger cash which earns no return or lock-up of funds in advances or securities which on the average earn much less than demand loans. When funds are released by cessation of seasonal demand, rates on call loans are governed by the simple principle that some return is better than no return and that investment should be of such duration as will release funds for use when the busy season returns. When call loans become scarce, borrowers have no alternative source to appeal to as in London but

* The automatic character of these rates is well illustrated by figures for two consecutive days on the eve of the present war.

LONDON.

	August 23, 1939.	August 24, 1939.
Bank-Rate	2	4
Discount-Rate		
60 Days	7/8	3 3/4
3 Months	1	3 7/8
6 Months	2—2¼	4½—5
Treasury Bills		
3 Months	7/8—1	3 7/8
Loans-Day to Day	¾—1	
„ Short-Loan		
Deposit-Allowances		

must put up with whatever levels these rates reach in sympathy with the demand loan rates.

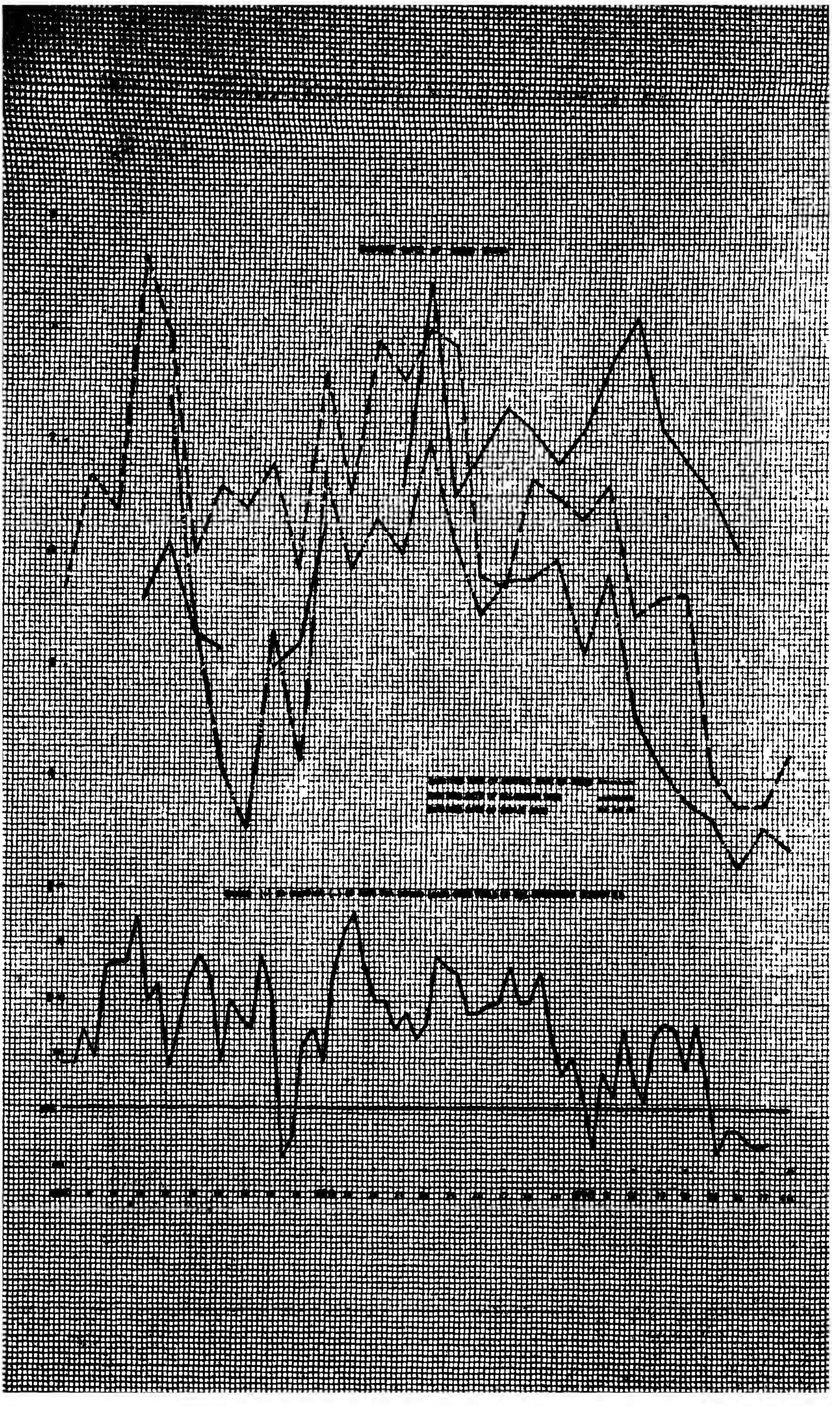
The Gross Rate of Earning of Banks generally*

Although we have no record of rates charged to customers separately, we are fortunate in having some indication of the levels of open market and customer's rates put together. Important banks publish figures which enable us to obtain rates of earning per cent. of funds at their disposal. The rate of earning does not represent indeed the full cost paid by the public for the use of banking funds. The resources of which gross earnings are expressed as a percentage include cash which is not lent out at all. This means that the actual cost paid by the public for funds lent out is a little higher than this percentage. Investments which are composed largely of government securities and into which a large proportion of bank funds finds its way present another difficulty. The gross rate of earnings represents on the whole the minimum level above which the public has to bear on the average a certain surcharge for banking accommodation.†

The earning rate of the Central Bank which is generally the lowest for the banks for which we have figures demonstrates again the high profitability of short-term finance in this country. The "bank rate" of the Imperial Bank and the Central Bank's earning rate do not maintain indeed a definite relationship. According to monetary conditions and cyclical influences, the Central Bank's earning rate is sometimes above and sometimes below the "bank rate." During the war years, when money was abundant, if not wealth, the rate fell below the "bank rate." From 1920 to 1927, when the world was generally suffering from very high interest-rates, the rate of earnings moved on to a distinctly higher level. In the few following years, it fell below the "bank rate" but after 1933, since customer's rates have always a rock-bottom level, the earning rate once more rose above the "bank rate."

* See foot-note * p 56 and ‡ p. 234.

† Table VII



The rate on short-term finance charged by the Central Bank could not be lower than that of the Imperial Bank. If its gross earning rate falls below the Imperial Bank's rate for demand loans it must be because of lower customer's rates or lower yield of investments.

The facts are materially different with the other three banks. These banks operate in areas of high rates in general and perhaps, the high deposit-rates they offer may be a factor in inducing them to seek business of a somewhat different kind. The earning rates of all of them are higher than the bank rate. Till 1933, the Punjab National Bank was content with a margin of less than 1 per cent. Thereafter with the fall of short-rates, the margin expanded to about 2 per cent.

Till about the end of the Great War, the Allahabad Bank kept its earning rate lower than the bank rate. Thereafter, circumstances seem to have forced the bank to revise its standards of acceptable business and its margin above the bank rate has been perhaps higher even than in the case of the Punjab National Bank.

The Indian Bank of South India has the highest earning rate and the highest rates charged to the public in India.* From 1910 till 1931, its earning rate has been well above 6½ per cent. and has on occasions exceeded 7 per cent. A margin of more than 1 per cent. and sometimes even 2 per cent. was very common. In the depression years, the earning rate fell a good deal but never below 3½ per cent. —the margin above the demand loan rate of Imperial Bank being more than maintained. The margin between its average deposit rate and its earning rate has been generally more than 2½ to 3 per cent. and even higher on occasions.

* Table VIII.

TABLE VI

	India. Yield on 3½ p.c. Rupee Security	India. Average Bank Rate	India. Excess + or Deficit of 2 over 1	United Kingdom (London) Yield on 2½ p.c. consols.†	United Kingdom (London) 3 mos. Bank Bills Market Rate	United States (New York) Treasury Bonds of more than 8 yrs. maturity. (Anl. Avg.)‡	United States (New York) Call Loan Rate Stock Exchange.
1865	4.8						
1866							
1867							
1868	4.8						
1869							
1870	4.3	5.16	+0.86				
1871	4.1	4.92	+0.82				
1872	3.9	5.31	+0.41				
1873	3.9	4.88	+0.98				
1874	3.9	6.41	+2.52				
1875	4.0	6.63	+2.63				
1876	4.1	6.70	+2.60				
1877	4.1	7.54	+3.44				
1878	4.2	6.12	+1.92				
1879	4.4	6.67	+2.27				
1880	4.3	5.01	+0.71				
1881	4.0	5.48	+1.48				
1882	3.9	6.27	+2.77				
1883	4.1	6.81	+2.71				
1884	4.1	6.41	+2.31				
1885	4.1	4.39	+0.83				
1886	4.1	6.00	+1.90				
1887	4.1	5.76	+1.66				
1888	4.1	5.59	+1.49				
1889	4.1	6.87	+2.77				
1890	4.0	5.92	+2.07			4.72	5.81
1891	3.8	3.01	—0.79			4.85	3.42
1892	3.9	3.50	—0.40			4.64	3.03
1893	3.9	5.01	+1.11			4.75	4.58
1894	3.9	5.30	+1.40			4.59	1.06
1895	3.4	4.18	+0.78	2.77	0.77	4.48	1.85

	India. Yield on Rupee Security.	India. Average Bank Rate.	India. Excess + or deficit of 2 over 1	United Kingdom. Yield on 2½ p.c. Consols.	United Kingdom. 3 mos. Bank Bills Rate Average	United States. Treasury Bonds etc.	United States. Call Loan Rate Stock Exchange.
1896	3.24	5.60	+2.36	2.69	1.39	4.54	4.21
1897	3.47	6.59	+2.92	2.71	1.78	4.38	1.77
1898	3.68	8.05	+4.37	2.84	2.56	4.21	2.16
1899	3.45	5.94	+1.49	3.02	3.15	3.96	5.04
1900	3.64	5.51	+1.87	3.14	4.32	3.95	2.93
1901	3.64	5.59	+1.95	3.24	3.20	3.79	3.98
1902	3.61	5.07	+1.46	3.24	3.90	3.77	5.22
1903	3.54	5.22	+1.68	3.42	3.57	3.96	3.79
1904	3.58	4.86	+1.28	3.43	2.61	3.92	1.78
1905	3.54	5.09	+1.55	3.42	3.24	3.82	4.39
1906	3.51	6.25	+2.74	3.55	3.83	3.94	6.44
1907	3.60	6.15	+2.55	3.75	4.28	4.22	7.27
1908	3.63	6.04	+2.41	3.72	2.33	4.16	1.97
1909	3.75	5.46	+1.70	3.79	2.15	4.00	2.70
1910	3.72	5.47	+1.74	3.84	3.16	4.14	2.97
1911	3.64	5.50	+1.86			4.16	2.57
1912	3.62	5.50	+1.88				
1913	3.66	6.17	+2.58	3.40	4.37		
1914	3.66	5.58	+1.92				
1915	3.8	5.65	+1.85				
1916	4.8	6.76	+1.35				
1917	5.1	6.47	+1.66				
1918	5.3	5.92	+1.17				
1919	5.0	5.97	+0.92			4.98	5.38
1920	5.9	6.20	+0.07	5.32	6.40	5.36	6.25
1921	6.2	5.57	—0.64	5.21	5.21	5.22	6.88
1922	6.4	5.81	—0.59	4.43	2.65	4.61	4.94
1923	5.7	5.95	+0.26	4.32	2.70	4.75	5.02
1924	5.2	6.68	+1.48	4.38	3.54	4.69	4.31
1925	5.1	5.64	+0.54	4.44	4.10	4.60	4.10
1926	4.7	4.82	+0.12	4.54	4.51		4.40

	India. Yield on Rupee Security	India. Average Bank Rate	India. Excess + or Deficit of 2 over 1.	United Kingdom. Yield on 2½ p.c. Consols.	United Kingdom. 3 mos. Bank Bill Rate (average)	United States. Treasury Bonds etc.	United States. Call Loan Rate Stock Exchange.
1927	4.4	5.71	+1.32	4.55	4.24	3.34	4.01
1928	4.6	6.19	+1.59	4.47	4.15	3.33	4.84
1929	4.9	6.22	+1.42	4.61	5.27	3.60	5.78
1930	5.1	5.88	+0.78	4.49	2.61	3.28	3.56
1931	5.5	7.04	+1.54	4.40	3.55	3.31	2.69
1932	5.7	5.02	—0.70	3.75	1.84	3.66	2.84
1933	4.3	3.56	—0.74	3.40	0.69	3.31	1.87
1934	3.9	3.50	—0.40	3.10	0.83	3.10	1.14
1935		3.46		2.89	0.56	2.70	0.91
1936	3.52	3.0	—0.52	2.94	0.59		
1937	3.63	3.0	—0.63				
1938	3.55	3.0	—0.55				
1939							
1940							

* Nov. 1919 to 1935, Customers Prime Commercial Paper.

† from 1895 to 1910 yield on Home Rly. Debentures.

‡ from 1890 to 1910—yield on 10 Rly. Bonds.

\+ 242; 246 Study of Interest Rates Kock.

TABLE VII

	Yield on 3½ percent Govt. Security on April 1st.	Average Rate on fixed and Current Deposits.				Central Bank.		Average Bank Rate	Average Rate of Earnings.			
		Allahabad Bank	Punjab National Bank.	Indian Bank.	Central Bank of India.	Average Rate on Fixed Deposits	Average Rate on Current Deposits		Allahabad Bank.	Punjab National Bank.	Indian Bank.	Central Bank of India
1910	3.7			3.33				5.46			5.69	
1911	3.6			3.95				5.50			6.70	
1912	3.6		3.12	3.50				5.50		6.57	6.44	4.12
1913	3.6	4.1	5.07	4.75	2.12			6.24	5.6	7.59	8.68	13.9
1914	3.6	4.4	4.05	4.78	6.6			5.58	6.1	8.14	7.93	7.14
1915	3.8	2.5	4.02	3.62	3.88			5.65	5.3	5.89	6.05	5.47
1916	4.3	3.4	3.77	3.09	2.45			5.65	5.2	6.24	6.63	4.13
1917	5.1		4.30	3.30	2.40			6.76		6.99	6.43	3.58
1918	5.3	2.5		3.90	3.48			6.47	5.0		6.83	5.31
1919	5.0	3.6		3.23	2.90			5.92	5.2		5.83	4.17
1920	5.9	4.9		3.90	4.28			5.97	7.0		7.56	6.71
1921	6.2			3.75	3.96	5.20	2.56	5.57			6.54	5.86
1922	6.4	2.3		4.12	4.23	5.68	2.45	5.81	3.2		7.93	6.33
1923	5.7	4.7		3.73	4.18	5.62	2.32	5.96	6.6		7.56	6.01
1924	5.2	4.9		4.18	4.78	6.58	2.46	6.68	8.4		8.02	7.04
1925	5.5	4.4	4.77	4.02	4.14	5.82	2.25	5.64	6.5	6.87	7.87	6.10
1926	4.7	4.9	4.69	3.95	3.63	4.96	2.17	4.82	6.9	6.49	5.81	5.45
1927	4.4	5.4	4.96	3.29	4.02	5.49	2.39	5.72	7.3	6.75	5.73	5.77
1928	4.6	5.2	4.59	5.59	3.98	5.30	2.46	6.19	7.1	6.43	6.66	5.79
1929	4.9	5.0	5.35	3.53	4.17	5.70	2 53	6.32	6.8	7.81	6.51	5.99
1930	5.1	5.3	4.43	3.64	3.23	4.47	2.01	5.88	7.1	6.68	6.32	5.12
1931	5.5	5.8	5.38	3.98	3.51	5.43	2.42	7.04	7.7	7.83	6.6	5.82
1932	5.7	6.2	4.30	3.22	2.66	4.70	1.98	5.02	8.1	6.06	5.44	4.58
1933	4.3	5.4	3.86	2.84	2.71	3.95	1.69	3.56	7.1	6.30	5.60	4.11
1934	3.9	4.8	3.20	2.48	2.09	3.01	1.35	3.50	6.8	6.63	5.63	3.83
1935	3.52	3.9	2.68	2.09	2.05	2.93	1.29	3.46	6.0	5.38	4.88	3.64
1936	3.63	3.3	2.37	2.11	1.60	2.59	0.98	3.00	5.5	4.82	3.75	3.24
1937	3.55		2.06	1.89	1.40	2.22	0.81	3.00		4.35	3.77	3.57
1938			2.18	2.08	1.31	2.05	0.77	3.00		4.94	4.24	3.37
1939					1.33	2.40	0.73					
1940												

TABLE VIII

Indian Money-Rate Per Cent

(Figures in Brackets indicate the approximate number of months for which the particular rate prevailed).

Years.	Yield on 3½ Govt. Security on April 1st.	Bank-Rate.	Call-Money Rates.		Imperial Bank Hundi-Rate.	Bazar Bill Rate.	
			Bombay	Calcutta.		Calcutta.	Bombay.
1922 ...	6.4	......	......	......	......	......	......
1923 ...	5.7	......	......	......	......	......	......
1924 ...	5.2	......	......	......	......	......	......
1925 ...	5.1	7(5) 5(4)	3(8)	1½ to 2½(6)	4½ to 5½(6) 7(4)	10 to 11(9)	8½ to 10 (7)
1926 ...	4.7	......	......	......	......	......	......
1927 ...	4.4	......	......	......	......	......	......
1928 ...	4.6	......	......	......	......	......	......
1929 ...	4.9	7(5) 5(4)	1½to 2(6) 6(3)	2½ (4) 5 (4)	7(4) 5(4)	11(7) 10(5)	9 1/16 (4) 5 5/16 (2)
1930 ...	5.1	......	......	......	......	......	......
1931 ...	5.5	7(5) 6(4)	5 to6½(9)	4 to 4½(8) 5(4)	7(5) 8(3)	7 to 8(8)	3-4(4) 6-7(6)
1932 ...	5.7	4(5) 6(2)	1 to 2(5)	1 to 2(6)	4(6) 5(3)	5 to 7(5) 7 to 8(7)	3-4(5) 6(4)
1933 ...	4.3	......	......	......	......	......	......
1934 ...	3.9	......	......	......	......	......	......
1935 ...	......	3½(11) 3(1)	1 (6) / ¾ (6)	2 to 3½(6) / ¼ to ½(6)	3½(10)	6 to 7(4) / 5-6 (4)	6¾ (6) / 3 to 4½(4)
1936 ...	3.5	3	½ (6) / ¼ (2)	½ (6) / ¼ (5)	3	5 to 6(12)	3 3/8 (6) / 5¼ (4)
1937 ...	3.6	3			3	......	......
1938 ...	3.5	3	¾ (5) / ½	1 / ½	3	7-8 (6) / 6/7 (6)	8 / 5 5/8

CHAPTER IV.

THE IMPERIAL BANK OF INDIA

THE idea of a central bank or a great state-bank for India is a very old one.* The first tentative effort towards the goal was, however, delayed till 1921 when the three Presidency Banks with their 68 branches were amalgamated into the present Imperial Bank of India. The amalgamation was largely the outcome of a *rapprochement* on the part of the banks themselves to whom the events and experiences of the Great War brought a new and broader outlook on the banking problems of the country. Their informal but profitable co-operation during the war coupled with the fear of an invasion from London banking interests gave them a keen realisation of the commonness of their interests. The intimate touch established between them and the Government in meeting the unusual circumstances of the war reinforced the same conviction. There was also the pressure of public opinion which saw in such an amalgamation a great instrument for the extension of banking facilities in the country.

The Presidency Banks

Prior to 1862, the Presidency Banks were directly controlled by Government and had to work within certain restrictions imposed on them by their charters. Along with other private banks, they enjoyed the valuable right of note-issue.†

In 1862, they were deprived of their right of note-issue, although they continued to manage the new government note-issue as agents to Government. As compensation for

* See foot-note ‡ p. 2. p. 4.

† The Bank of Bengal founded in 1809 was for example restricted in the following ways Advance to an individual could not exceed 1 lakh and to Government 5 lakhs. Interest charged was limited to a maximum of 12 p.c. corresponding to a similar maximum of 5% in England. Cash-reserve was to be at least 1/3rd of demand-liabilities while total liabilities—deposits and notes—were not to exceed the capital which was 50 lakhs. In 1823, the note-issue was fixed at a maximum of 2 crores and cash-reserves at a minimum of one-fourth of demand-liabilities. In 1839, the charter fixed maximum advance to an individual at 3 lakhs and currency of a loan at 3 months. The security prescribed was two un-connected persons. Bills discounted must be payable in India only.

the loss of their valued privilege, they were freed from many of the old restrictions on business and were given the use and management of government balances. In 1866, the Government themselves assumed the management of the paper currency.

The danger of these relaxations of law were speedily illustrated by the behaviour of the Bank of Bombay. Apart from negligence or incompetence of the Presidents and Directors of the Bank, the abuse of powers given by Act X of 1863 to the Secretaries, the absence of sound legal advice and assistance, etc., the chief cause of the failure of the Bank undoubtedly lay in the legal changes made after 1862. The Bank of Bombay Commission which inquired into the whole lamentable episode put the point in quite an emphatic manner. "It may be," they wrote, "that the old Act was unnecessarily restrictive but that did not justify the removal of all restrictions. . . . They opened the door to great laxity of practice and a ruinous system of banking, and were in fact the chief cause of the Bank's failure."

The Presidency Banks Act of 1876 restored substantially the old restrictions, prohibiting the Banks from conducting foreign exchange business, borrowing or receiving deposits payable out of India, from lending for a longer period than six months, or upon mortgage or on the security of immovable property or upon promisory notes bearing less than two independent names, or upon goods, unless the goods or titles to them were deposited with the bank as security. The government balances at the disposal of the Banks were strictly limited. At the same time, Government sold out their share holdings in the Banks and ceased to appoint official directors.

The only notable change in the long period which ensued till the amalgamation of 1921 was the increase, during the Great War, of government balances at the headquarters of Presidency Banks, the object being to assist the money market in its periodic stringencies.

The Imperial Bank of India. 1921-1934

Under the amalgamation scheme, the paid-up capital of the new bank was increased from 3¾ crores to about 6 crores, raising the ratio of capital and reserves to total public and private deposits from 9·6 per cent. in 1920 to 13·7 per cent. in 1921.*

The public character and responsibilities of the Bank were secured in no uncertain manner. The Managing Governors, not exceeding two in number, were to be appointed by the Governor-General-in-Council. Besides the Managing Governors and the representatives of Local Boards, the Central Board which was the controlling authority was to include the Controller of Currency or some other comparable officer and four or less non-officials, all at the nomination of the Governor-General. The Governor-General was empowered to issue instructions to the Bank with the specific object of safeguarding government balances or the financial policy of the Government. The Controller of Currency or the officer nominated in his place was to act as the watch-dog of the Government and in aforesaid matters, could exercise a suspensive veto pending final decision of the Governor-General-in-Council.

An agreement between the Bank and the Secretary of State re-defined in certain material particulars the business of the Bank.

The management of the public debt as hitherto and all the general banking business of the Government of India were vested in the Bank. The Bank was to hold hereafter all the treasury balances. The Government agreed to transfer funds for the Bank through Currency free of charge and discontinue the issue of currency transfers or supply bills in all those places where the Bank existed to serve the public. The Bank was now allowed to open

* (Figures in crores.)

	Prior to Amalgamation. 1921.	Post-Amalgamation. January 1921.
Authorised Capital	3¾	11¼
Paid-up Capital	3¾	5 3/5
Reserve Fund	3 2/5	3 3/4
Deposits	76	76 2/5
Government-Balances	6 9/10	7 9/10

office in London but it could not open cash credits for, or receive deposits from anyone other than its old clientele.

In return for all these valuable privileges, the Bank undertook to open within five years 100 new branches, of which the Government was to determine the location of one in four and further, to give the public facility for transfer of money between its offices at rates to be approved by the Controller of Currency. To no part of the Imperial Bank Act of 1921 did public opinion attach greater importance than this undertaking to extend banking facilities. The presence of a bank whose position and stability were beyond all doubt and which could keep their cash balances was expected to have a very uplifting effect on local banks. The management of work connected with government securities at each local branch, instead of at the headquarters of government as formerly, was expected to stimulate interest in productive investment and in banking generally.

By March 1926, the Bank fulfilled its legal obligation to create these new branches. Of 102 new branches, 36 or about 1/3rd were located in places where there was previously no bank of any kind. As many as 89 were located in places where there were government treasuries or in other words, government balances to be taken possession of.

Schedule I to the Act of 1921 defined the business of the Bank both positively and negatively in two separate parts. One part set forth the business which was absolutely prohibited to the Bank. The other part indicated the business which the Bank was permitted to undertake.

The existence of special laws and charters throughout their history prove that the Presidency Banks and their successor, the Imperial Bank of India have held and been meant to hold special status and fulfil special functions in the banking structure of India. Laws and charters have however aimed at two specific objectives only, the safeguarding of public funds and the extension of banking

facilities. But more peremptory than the force of law was the pressure of actual needs and circumstances which tended gradually but surely to widen the public character and responsibilities of the Bank. In this continuous growth, a critical stage was reached when the Hilton-Young Commission of 1926 raised the question of a Central Bank for India as the next logical step in the organisation of currency and credit. It was inevitable that for this purpose, all eyes should turn, in the first instance at least, to the Imperial Bank as the instrument most easily available at hand. But to the Hilton-Young Commission, it seemed an unquestioned and unquestionable presumption that central banking function and commercial banking activities could not and should not go together. To dismantle the Bank of its commercial functions was in its opinion to arrest the progress of the country in the one sphere in which progress was most urgent and vital.* The creation of the Reserve Bank of India in 1935 gave effect to this conclusion and closed, so far as law can close, future growth of the Imperial Bank along these lines. But as history reveals again and again, practical necessities are apt to overbear and in the end dominate the limitations of mere laws. Despite the Reserve Bank Act of 1934, the Imperial Bank holds and must continue to hold a unique place in the banking system of this country. The causes, outside, if not inside, the framework of law which gave it this unique position have not yet ceased to operate and it would be hardly surprising if the course of evolution gradually led it into a position not contemplated by the framers of law. To analyse these causes is to analyse the manner and character of the past and present working of the Bank to which we must now address ourselves.

Size and Power of Imperial Bank

By its size alone, the Imperial Bank has been well situated to exercise great power over the credit structure of the country. Its private deposits have amounted generally to one-third of the aggregate deposits of banks

* Report. Paras. 87, 88.

in India. By 1926, it had more than twice as many branches as all exchange banks put together and as compared with Indian joint-stock banks, it had more than one-third of theirs. A bank with such enormous resources, expanse and clientele could always be sure of forcing others to follow its lead, when such lead was in conformity with operative circumstances. Its rate changes and policies could be depended on to attract or repel as circumstances required borrowers on a scale which was sufficient to put the necessary pressure on other banks.*

This great position of the Imperial Bank has been built largely no doubt on the basis of its special connection with the government of the land. This connection gave it command over a large and dependable volume of public funds which were of especial use in the early stages of its career. But more decisive than the funds themselves was the general confidence arising out of the belief that the government were deeply concerned in and could be trusted to take measures to ensure, its stability and solvency.

The great drawback of periodic withdrawal of large funds from the market into government treasuries was not abolished however, at a single stroke. Although the Imperial Bank and before it, the Presidency Banks were entrusted with government balances, the assistance to the market was limited at first to certain maxima and even after the maxima were abolished, to those places only at which these banks had their branches. With the growth of the branches of the Imperial Bank, government funds began to flow into the market in a larger and larger volume. Government on its part made efforts to reduce the amounts kept at out-stations by instituting currency chests at sub-treasuries and transferring surplus funds there to these currency-chests against a corresponding

	* Total Deposits. (Private ; in crores.)	Percentage of Deposits of Imperial, Exchange, Big Five Indian Joint-Stock Banks.	Percentage of Private Deposits of Imperial Bank to Total.
1914	87	91.8	45.8
1920	226	84.4	34.4
1930	212	90.0	36.0
1934	227	86.1	32.6

transfer from Currency Reserves at the headquarters to their balances at the Imperial Bank.*

On this point of size and power, the Imperial Bank invites comparison most appropriately with Banque de France which throughout its long history has combined, and combined effectively, central banking with commercial functions. Leaving aside Caisse des De'pot et de Consignations which manages public funds, savings bank deposits, post office cheque accounts, etc., and the Banque d'Affairs which are mainly industrial banks, the Banque de France held less than a quarter of the banking resources of the country. The six big deposit banks of Paris with their affiliates alone claimed more than twice the deposit-resources of the Bank de France. Yet, through its 600 and odd branches and about 4 lakhs of accounts, the Banque de France is able to make its lead and power felt throughout the country.†

Conflict of Commercial and Central Banking Functions

While the size and resources of the Imperial Bank gave it a ntural leadership of the Indian banking system, it was a matter of doubt to many whether an ordinary com-

* (In Lakhs.)

	Average Monthly Balances at Treasuries and Sub-Treasuries.	Average Month-end Balances with Presidency or Imperial Bank.§	Percentage of Public to Private Deposits.
1911-12	1,880	414	......
1912-13	1,901	451	......
1913-14	1,909	560	......
1917-18	1,242	1,282	......
1918-19	849	1,081	......
1919-20	679	1,157	......
1920-21	625	1,261	......
1921-22	509	1,391	10
1922-23	400	1,825	25
1923-24	340	1,661	12
1924-25	295	2,087	10
1925-26	267	1,638	7
1926-27	249	1,919	9
1927-28	280	1,056	10
1928	......	......	11
1929	......	......	11
1930	......	......	10

§ These balances fluctuate according to the issue of treasury bills, remittances of Government of India to Secretary of State, etc.

† Relative Position of Different Classes of Banks in France. 1937.

(Figures in Million Fcs.)

	Capital and Reserves.	Deposits.	Note-Circulation.
Caisse des D'pot et des Consignations. ‡ ...	......	100,000	......
Banque de France	500	16,000	86,000
6 Deposit Banks and Affiliated Banks ...	8,500	37,000	......
Independent Provincial Banks	1,000	6,000	......
Banque D'Affairs	1,000	4,000	......

‡ a State institution managing savings banks' deposits, post office cheque account and many public funds including sinking funds.

mercial bank could be trusted to dscharge these responsibilies in a loyal manner. A commercial bank must exist first and last for making the largest profits while a central bank has on occasions to forego profit in the interests of the country at large. When an incipient boom has to be checked, a commercial bank may well be disinclined to incommode its customers and to diminish its profits by advancing its rates earlier than its competitors. Still greater is its embarrassment in an obstinate depression when the rate may have to be reduced below the economic level. The same unpleasant choice confronts it with regard to open market operations. When rates are rising in the course of a boom and securities depreciate in consequence, the central bank has often to sell off these low-priced securities to stave off a serious crisis. When a depression sets in with low rates and high security prices, the central bank has to buy these very securities to increase the cash basis of banks and induce lending. The dilemma is resolved in the case of most central banks by statutary or voluntary limits and checks on their rates of dividend.

Firstly, as regards the bank's obligations towards its own customers. The rate of a central bank is effective less by its level, which must always maintain touch with market-rates, than by the conditions of eligibility attached to it. Except in England, the declared rate is a minimum rate for bills of certain stringently defined qualities and length but the bank's established customers can always take to the bank bills of other qualities and length and obtain funds at almost the usual rates. As for advances, the rates are always subject to a certain minimum below which the banks hardly ever descend. It seems unlikely therefore that a commercial bank engaged in central banking functions will be embarrassed in regard to its usual customers.

Even then, it must be admitted that not every country is equally well situated to attempt a combination of central banking and commercial banking functions. The Banque de France is an excellent example of how policy

and circumstances may conspire to bring about a happy combination of this kind. With few sensitive elements in its export trade and with a perpetual need of finding investments for surplus savings abroad, French economy is well suited to run on an even keel, not much disturbed by economic changes in the outside world. The Banque de France improves on these advantages by a policy which aims at accumulating immense gold reserves against its enormous note-issue and by using them freely to aid foreign central banks in difficulties no less than to meet internal demand for hoarding or export. These basic economic facts and the banking technique reared on them find their objective expression in the exceptionally stable rates which mark French monetary conditions. Between 1898 and 1914, the Swiss National Bank changed its rate 56 times; the Reichsbank, 62 times; the Bank of England, 79 times. But the Bank of France found it necessary to change its rate only 14 times.

The position of India is materially different. There are many sensitive elements in our export trade and with the distribution of economic power as it is, our imports are relatively inelastic as experience has indeed demonstrated again and again. Our obligations to foreign investors on private account are large and our obligations on public account, although less in bulk, link our taxation-system to our monetary system.* Until these obligations are materially reduced or abrogated, the maintenance of an export surplus comparable with the volume of these obligations must be the main concern of our monetary authorities. In other words, co-operation with our foreign markets and foreign creditors must be our goal rather than monetary autonomy on French lines. Whether and to what extent co-operation can be distinguished from mere submission to the lead from abroad is a delicate point which involves consideration of our political relations with the largest of our creditors, namely, Great Britain.

To take up the next point regarding the losses which are involved in the discharge of central banking functions. It

* The latest estimate of British Investments in India is 11,000 m £.

is a point worthy of close inquiry whether such losses are not more than counterbalanced by the interest-free funds of government and the compulsory deposits of commercial banks with the central bank. In the 7 years 1921-22 and 1827-28, the average month-end balance of government funds with the Imperial Bank was about 16·6 crores. During the years 1935-36 to 1937-38, the average deposits of scheduled banks with the Reserve Bank of India were in the neighbourhood of Rs. 26 crores. It would be a moderate estimate to place the average interest-free balance available to a central bank in India at about 40 crores in round figures. At the average net profit rate of the Imperial Bank for the years 1935-1936, this should give the Bank an annual income of about 58 lakhs or about half the net aggregate profits for these years. This is surely more than a generous margin for any losses which a bank could incur in the critical stages of a boom or depression. The steady dividends of most central banks of the world are convincing proof that central banking is not incompatible with good profits.

High Liquidity of Imperial Bank Assets

Design and practice combined to give the assets of the bank a degree of liquidity worthy of a central bank charged with the duty of aid to banks in difficulties and the management of the note-issue and legal tender of the country.* Legal stipulations regarding the duration and security of loans and bills prescribed as early as the law of 1876 are almost the same as in the charters of many central banks like the Bank of France. The practice of the bank was indeed even more conservative than the law itself. While the law allowed bills a maximum maturity of 90 days, the actual maturity of bills discounted was on the average 60 days only.* In the absence of a sufficient quantity of bills, loans were kept within strict bounds while cash credits which are terminable on demand were generally twice in volume and in adverse days, much more. Advances on security of one name were the exception rather than the rule.†

* Tables IX and X.

† Qs. 9599; 9590; 9600; Minutes of Evidence Hilton-Young Commission. One-name paper is not a marked feature of Indian business.

Of course, an even higher degree of liquidity is common among the central banks of the world. Although the law fixes 90 days as the maximum maturity for ordinary bills and 9 months for agricultural bills, the average maturity of bills actually discounted by the Federal Reserve Banks did not exceed 8 days in fairly normal years like 1925 and 1926. The practice of the Bank of France with its direct discounting for individuals and concerns is even more relevant and illuminating. From 1927 to 1934, years of great strain and stress, the average maturity of bills discounted was only 18 days in 1927 and though it rose subsequently, the maximum reached was only 33 days in 1933. It must however be remembered that bills are more abundant in the United States than in India and that in France, they are the chief outlet for bank funds.

Profit and Loss Account.

Analysis of profit and loss account makes it clear that inspite of restrictions of law, there was a most generous scope for profitable business. The margin of profit was always so large that any reasonable restrictions imposed in the interests of central banking were not likely to make the bank less profitable for the existing share-holders or prospective investors.*

Barring the Indian Bank of Madras in which province highest rates prevail as a rule, the Imperial Bank has always had the highest rate of gross profits of which we have any record. Till 1932, the rate rarely fell below 3·25 and was usually at least 1 per cent. in excess of the next best rate earned by the Allahabad Bank of India. Even after 1932, although the differences narrowed among Indian banks, the rate of the Imperial Bank did not fall below 2·50.

Its expense ratio however has been midway between the most economically and the least economically run Indian banks. The ratio showed a tendency to rise in the years after the Great War but after the 1929-30 crisis, it has declined in a significant manner. A more rapid pace of

* Table XXXIII and XXXIV

Indianisation, etc., is likely to prove a more permanent influence on this ratio than economy expedients improvised to meet recent difficult years. Some justification for this belief is found in the proportion which salaries bear to the aggregate expenses of the bank. Of the large gross profits it earns, larger per unit than in the case of any other important bank, as large a proportion as 35 to 40 per cent. is spent on salaries. Its expenditure on salaries compares favourably only with that of the Allahabad Bank of India whose rate of gross profits stands next to the Imperial Bank's. The fraction shows a remarkable stability from year to year but may be expected to fall as the employment of foreign skill and direction is discontinued.

Its rate of net profits is more decisive on the point we are seeking to establish. The rate for the Imperial Bank is easily the highest among those for which we have any record. Always more than 1·60 per cent. of resources employed, even the last depression could not reduce it below 1·10. As a percentage of capital and reserves, which themselves have always borne a steady and high ratio to deposit-liabilities round about 13 to 14 per cent., net profits are well above 10 per cent. as a rule.*

Imperial Bank and Competition with other Banks

No argument weighed so much in favour of the creation of a new institution as the fear of the incompatibility between competition in business and national leadership. Limitation of profits is no doubt one obvious means of reconciling the two. Restrictions on business such as the Presidency Banks and the Imperial Banks have always had to conform to, is a still more direct means of attaining the same objective. But far more important than legal prohibitions and restrictions are tradition and habits growing out of natural evolution. We must examine how far past history was tending to fit the Imperial Bank for such a role.

National leadership depends on two factors. It may grow out of a historical environment of mutual trust and habits of informal co-operation. The growth of such an environ-

* Table XXXIII

ment may be initiated or facilitated by the manner in which the executive of a bank is constituted. The two, although interdependent, deserve to be analysed separately.

It appears that the competition of the Imperial Bank became a source of constant complaint only after the amalgamation of 1921 and the subsequent creation of branches. The Allahabad Bank, in particular, was loud in its out-cry before the Hilton-Young Commission. It was on record, however, that out of 88 new branches created by 1926, as many as 75 were located in places where no bank had any branch before. The new branches competed with the Allahabad Bank in 12 places only and even among these 12 places, there were at least 4 in which the Allahabad Bank was already confronted with competition from the Alliance Bank of Simla.*

It is difficult to set any narrow or definite territorial limits to the effective influence of a new branch.† This influence is apt to extend far beyond the town or place in which the bank-branch is located in the physical sense. A range as wide as 100 miles round-about was mentioned as the radius of this influence.† There was perhaps an element of exaggeration in the statement. It is nevertheless necessary to ascertain how far the Imperial Bank gave any reasonable grounds for complaint on the score of unfair or uneconomic rates.

Unfortunately, the Imperial Bank does not publish figures of its total earnings like some other banks. It is not, therefore, possible to compare its rate of earning per unit of funds employed with the rates of other banks. Its gross profit rate, as we have already recorded, is the highest in our table and is apt to stand above the next highest rate, namely, that of the Allahabad Bank, by an impressive margin. The gross profits rate may be high either because the Imperial Bank is able to charge very high rates or because it has to pay a relatively lower price for the funds it obtains. Since the complaint is one of unfair competition for business, it is clear that rates of

* Qs. 9648-51; 9681; Table 13, p. 479, Appendices, Hilton-Young Commission.

† Ibid. Qs. 12002; 12004; 11967.

the Imperial Bank are alleged to be uneconomically low. It was asserted before the Hilton-Young Commission that when the Allahabad Bank quoted 7½ per cent., the Imperial Bank was found to be content with 5 per cent. The more usual difference between the rates of the two banks was given out as ½ to 1 per cent.*

There could be no complaint of unfair competition if the low rates which the Imperial Bank paid to its depositors bespoke merely the confidence which the public reposed in the Bank on account of its better management. But the argument was that these low rates were due to the special privileged position of the Bank. Vast funds free of interest were placed at its disposal in the course of the management of government revenues and expenditure or the public debt services. Besides, Government transferred funds for the Bank through Currency free of charge. These privileges, it was suggested, enabled the Bank to offer accommodation to the public at uneconomic rates and yet to maintain the highest rate of gross profits among Indian Banks.

It will be recalled that except in the year 1922, the proportion of public to private deposits never exceeded 12 per cent. For many years, it was much less than 12 per cent.† Even if 1/6th of the total funds it employed were assumed as free of interest, and the rates paid by the Imperial Bank on its other deposits were taken to be as high as those of the Central Bank of India, the former could not account for an advantage in the gross rate of more than ·6 to ·7 per cent. Actually, the difference between the gross profit rate of the Imperial Bank and the Allahabad Bank is much more than 1 per cent. perhaps nearer to 2% than 1 %. It is self-evident therefore that the larger size of its gross profit rate was due as much to its ability to attract funds cheaply as to the funds placed at its disposal by the Government.

It is also probable that a part of the explanation is to be found in the composition of the private deposit

* Qs. 12084; 11957; Minutes of Evidence. Hilton-Young Commission

† P. 506. Appendices. Hilton-Young Commission.

liabilities of the Imperial Bank and other Indian banks. We have evidence for the Imperial Bank only for the war years 1915-17, 1919 and the post-war year 1925. In these years, the Banks of Bengal and Madras showed fixed and savings deposits to be about 33 to 45 per cent. of all deposits. For the same years, the percentage for the Allahabad Bank was as high as 77 per cent. for fixed and saving deposits. When we recall that even for the Central Bank of India, the average difference between rates paid on fixed and current accounts is about 2·5 to 3 per cent. and that the Imperial Bank pays no interest on current accounts, the ability of the Imperial Bank to quote lower interest-rates on its loans is seen to be due not entirely to uneconomic competition.*

It is rather significant that the loudest outcry has generally come from those areas where high interest-rates prevail generally. One such area is the Punjab and the United Provinces where the Allahabad Bank and the Punjab National Bank carry on their main business. Another such area is South India where the Indian Bank and a large number of small banks ply their trade. The relative level of gross earnings of different banks is a good indication of the conditions amidst which these banks lend their funds. The Central Bank of India with its branches more or less evenly distributed in all parts of India may be taken as the type of banks which are neither exceptionally favoured by high interest-rates nor exceptionally prejudiced by low rates. Yet, the Allahabad Bank and the Punjab National Bank are able to maintain their gross earning rate at one per cent and more above the rate of the Central Bank of India. In the years after the crisis of 1929, the differences have widened still further in favour of the aforesaid two banks, 2 and 3 per cent. being quite common. The earning rate of the Indian Bank is much higher, an excess of 3 per cent. and more above the

* Imperial Bank (lakhs. Last Week, March 1925).

			In Percentage of Total Deposits.	
	All-India.	Bengal Circle.	All-India.	Bengal Circle
Current Accounts ...	1,544	3,717	55.1	59.1
Fixed Deposits ...	1,256	2,408	44.9	40.9

Pp. 39-40. Bengal Provincial Enquiry Committee Report

Central Bank rate being quite common. This leads to the conclusion that while sporadic cases of a drastic use of its power by the Imperial Bank could be cited here and there, a general tendency to the lowering of rates on account of the appearance of the Bank on the scene was but a natural effect of the aforesaid conditions and could hardly be a ground for legitimate complaint on the part of other banks.*

It is not sufficient merely to prove that the complaints of certain banks were not altogether well-founded. A bank which is moving towards the leadership of a banking system must actively foster and justify confidence in itself. As the history of the Bank of England proves, a tradition of such confidence is slow to grow and has to progress through much difficulty and misunderstanding. There is, however, some evidence that the Imperial Bank was slowly establishing for itself a somewhat analogous position.

One great obstacle, perhaps the greatest obstacle was ignorance—ignorance on the part of the public as well as banks. This was well illustrated by the crisis of 1913. The Allahabad Bank found itself in an embarrassing situation because a rumour spread that it had asked for assistance from the Imperial Bank.† For a long time thereafter, the Allahabad Bank made it a policy not to borrow from any big bank to meet even temporary difficulties. Unwillingness to borrow from a rival on grounds of prestige is to be met with even in advanced countries like France. But backwardness of public sentiment is an additional difficulty in the adoption of what in other countries would be looked on as normal and natural banking operations.

Things however tended to gradual improvement with the passage of time. In the twenties of the present century, the Bengal National Bank had cause to express gratitude for the willing assistance rendered by the

* Q. 11866-11870; 12061. Minutes of Evidence, Hilton-Young Commission.

† Q. 12263. P. 419 Table No. 18. Minutes of Evidence. Hilton-Young Commission 1926.

Imperial Bank. The special position of the Imperial Bank was brought into greater prominence by the events subsequent to the failure of the Alliance Bank of Simla Ltd., on 27th April, 1923. Acting under instructions of Government and a guarantee of the Finance Dept., the Imperial Bank undertook to pay immediately 50 per cent. of the amounts due to depositors inclusive of current accounts and savings bank accounts. To enable the Bank to meet such situations with promptitude and effectiveness in the future, an amendment was enacted shortly afterwards by which the Bank was empowered to advance or lend money to a banking institution with a rupee capital upon security of its assets with the specific object of averting or facilitating a winding-up.*

The more enlightened among the banks have shown from very early days a better appreciation of the position and responsibilities of such a Bank. They have entrusted their surplus cash balances and a certain proportion of the Imperial Bank's private deposits is accounted for by this practice. The volume tended to fluctuate according to the demands of trade. We have it on the authority of the Central Banking Inquiry Committee's Report that in 1925 these balances varied between such wide limits as Rs. 2 crores to Rs. 13½ crores. The figures given for March and September of 1928, 1929 and 1930 by the same Report show these balances at about 3 to 4 crores. The funds borrowed by the banks from the Imperial Bank varied in a like manner.

Character of Executive, Ownership and Personnel

A powerful influence in the creation of such leadership is the public confidence that the character of the executive, ownership and personnel is such as to conduce to national outlook and conservation of public interests. This condition is satisfied in most countries by vesting the power to appoint the executive in the government or making the appointment subject to its confirmation. Some countries go much further in these safeguards. As our account of

* P 24. Vol. I. Indian Central Banking Inquiry Committee Report

this history of the Imperial Bank indicates, the constitution of the executive has always been recognised as a national concern and more emphatically so, in the changes of 1921. The history of the Bank of England should be sufficient assurance that with this initial advantage, the course of development might have followed similar lines but for the decision of 1926-1934.

The public mind in India was impressed not so much with the policies of the Imperial Bank as the large European element in its personnel and clientele. For a long time, there has been an undisguised suspicion that the presence of this element made the Bank more solicitous of alien banking and commercial interests. Many changes in the desired direction, particularly, Indianisation of personnel have taken place in recent years. But the close alliance between the Bank and British commercial interests still persists, albeit to a more limited extent now than formerly.*

The evidence tendered before the Chamberlain Commission as long ago as 26 years showed that 4/5th of the shareholders of the Bank of Madras were Indians. Out of 732 lakhs of advances, 588 were advanced to Indians. 3/5ths of the deposits of the three Presidency Banks belonged to Indians. Of the aggregate advances of the Bank of Bombay, 5/6ths were made to Indians and Indian industries. By 1925, the situation improved still further. Of individual deposits, Indians then held 67 per cent. as against 33 per cent. held by Europeans. Of advances, 68 per cent. went to Indians as against 32 per cent. to Europeans. Of the deposits of banks, one-quarter belonged to Indian banks but of advances, more than one-half were made to Indian banks.† In spite of this growing stake of Indians in the Bank, the

* Distribution of Shares of Bank of Bombay. (1840).

		No. of Shares.
178	Europeans (Resident in India)	3,261
12	Native Christians	49
3	Muslims	55
109	Parsees	1,368
85	Hindus	327
	Government Shares	5,000

Cooke. Banking in India. P. 165.

† Q. 1689; 9832; 9855; 9857, Minutes of Evidence Vol. II. Chamberlain Commission 1912.

Last week of March 1926. (in Lakhs.)

	Indian Banks	Other Banks.
Deposits	185	576
Advances	306	223

Q. 9750. Appendix No. 48. Hilton-Young Commission.

supreme direction of the Bank has always remained in non-Indian hands.

Seasonal Character of its Business and Rate Variations

It would be more legitimate to blame the Imperial Bank on the ground of its almost total failure to prevent a very wide range of seasonal fluctuations in interest-rates* and the very high levels which they reached in certain times of the year. The retention of the ultimate control of currency in the hands of the Government and the peculiar arrangement by which aid from currency reserves was made dependent on particular levels of the bank-rate were no doubt aggravating factors in the situation. Still, it cannot be doubted that it lay in the power of the Imperial Bank to moderate the range of fluctuations but it preferred its own profits to national interests and exploited to the full the highly seasonal demand for currency.

The burden of meeting the seasonal demand was supported largely by the Imperial Bank. This was a consequence largely of the prohibitions laid on it against engaging in any but truly short-term and self-liquidating business. Great variations in cash rather than in any other assets of the bank were the main technique employed by the Bank for this seasonal adaptation. When seasonal demand rose, cash was permitted to fall to comparatively low levels. When seasonal slackness caused the inevitable fall in loans, cash-credits and above all in bills, the inflowing repayments merely went to swell the cash. Investments which are composed almost entirely of government paper could not be availed of for the purpose since depreciation and capacity of the market are factors to be reckoned in. In the stable years 1923-1929, between the month of March and September, an average fall of about 7 per cent. in cash credits, 5 per cent. in loans and 7 per cent. in bills measured on the basis of the volume of deposits was offset by an increase of more than 16 per cent. in cash. The increase in investments is so slight as to be hardly comparable and reflects more

* During the 10 years 1921-30, the rate for demand loans of the Imperial Bank stood at 9 p.c. for approximately 3 weeks, 8 p.c. for 47 weeks; 6 p.c. for 140 weeks; 5 p.c. for 129 weeks; 4 p.c. for 81 weeks.

truly a secular trend.* In contrast with this high seasonal trend of the balance-sheets of the Imperial Bank, the balance-sheets of other Indian joint stock banks hardly disclose much seasonal variation.†

Analysis of aggregate monthly advances for the years 1921 to 1930 suggests June as the month lying midway between the peak and trough of the seasonal demand for money. In March or April, business demand reaches its full height, the average level of advances as a proportion of deposits being about 15 per cent. over the June level. September records the lowest level, about 14 per cent. less than in June. The average difference in advance in the aforesaid years was 15 crores between the peak and trough months while the average cash-balance held in March was about 18 crores and in September above 30 crores.

Seasonal demand by itself need not cause embarrassment to individual banks or to the banking system as a whole. When the outflow of cash at one time of the year is certain to be followed at another time by inflow on the same scale, variations in cash caused by them cease to have much significance for safety or liquidity of bank assets. When interest-rates show a wide range of seasonal variation, it is apt to bespeak more the character of the monetary organisation of a country than the inevitability of such monetary rhythm. The demand for finance, for example, has assuredly a far wider seasonal range in the United States than in England. Yet even before the advent of the Federal Reserve system, the monthly averages of rates on prime commercial paper for the years 1890-1900 gave a spread of 1·04 only. The spread in England for the period

* Average Percentage to Total Liabilities. (Liabilities Capital, Reserve, Public and Private Deposits.)

		1921-1922.		1928-1929.	
		March.	September.	March.	September.
Cash	...	24.8	32.5	16.5	32.8
Loans	...	19.7	22.8	17.8	12.2
Cash Credits	...	29.9	24.4	34.1	26.7
Bills	...	10.9	5.9	11.7	4.8
Investments	...	13.8	12.6	16.7	19.9 & Table XI

† 55 Scheduled Banks (Including Imperial Bank).

		(Average Percentage to Total Liabilities).	
		March.	September.
Cash (1935-36 ; 1938-39)	...	12.81	14.88
Bills and Loans (1937-38 ; 1938-39)		54.20	46.84 and Table XII

1882-1913 was 1·50 for average Floating Rate and 1·70 for average discount-rate for 3 months bank bills. The greater spread in England is explained by the fact that the money market cannot replenish itself at the Bank of England unless the market rate rises to the bank-rate and the bill-brokers are forced into the Bank. In India, the Imperial Bank which had some of the privileges and a few of the responsibilities of a central bank preferred to raise its rate to the point of maximum profit rather than allow its cash to fall low in the interest of stable rates. The fact that the level of cash in the busy month of March was on the average as high as 16 per cent. of deposits during the twenties of the present century proves what a large margin there was for a more rational rates policy. Unfortunately Government also set its imprimatur on unstable rates by linking aid from Currency Reserves with certain prescribed levels of the bank-rate. A more rational policy has had to await the creation of a central bank placed above the motive of private profit.*

Imperial Bank after 1934.

The Reserve Bank Act of 1934 put an end to or at least sought to barricade the growth of the leadership of the Imperial Bank along certain lines. That law caused certain changes in the position and powers of the Bank which we must now proceed to assess.

The Bank ceased to be the banker to Government. The Government, on its part, practically withdrew from the management of the Bank. In the general interests of the country, however, power was reserved to the Governor-General-in-Council to nominate to the Central Board non-official persons not exceeding two in number. Contact between Government and the Bank was assured by the nomination by Governor-General of an officer of Government entitled to attend the meetings of the Central Board, to take part in its discussions but not to vote. This arrangement is an obvious recognition of the unique place of the Imperial Bank in the financial and banking interests of the country especially in times of crisis and war.

* Kock, "Study of Interest-Rates," pp. 110-114.

With the withdrawal of special privileges and government control, the justification of old restrictions on the business of the Bank ceased.

The Bank was now authorised to transact foreign exchange business, to open branches and undertake banking business of any kind inclusive of borrowing abroad. It was allowed to buy bills of exchange payable abroad and of a usance not exceeding nine months in the case of bills relating to the financing of seasonal agricultural operations and six months in the case of other bills.

In the case of advances or loans relating to the financing of seasonal agricultural operations, the period of six months was extended to nine months. The Bank was now permitted to acquire and hold, and generally to deal with, any right, title or interest in any property movable or immovable which may be the Bank's security for loans and advances or may be connected with any such security. The security for loans and cash credits was now widened to include municipal debentures or securities, when permitted by the Governor-General-in-Council, of a Native State of India, the debentures of limited liability companies approved by the Central Board, etc.

Under an agreement between the Imperial Bank and the Reserve Bank which will last in the first instance for 15 years and which may terminate with 5 years' prior notice on either side, the former is to act as agent for the latter in all places in British India where it has a branch and the latter has got none. The Imperial Bank shall also perform in those places the usual functions on behalf of Central and Provincial Governments and the Railway Board. For these latter services, the Imperial Bank is to receive commission at certain rates on the volume of transactions for the first ten years and the actual cost for the next five years and, if necessary, thereafter also.

TABLE IX

Imperial Bank of India. (Balance-Sheet December 31st) (Figures in Lakhs)

	Paid up Capital.	Reserve.	Total	Deposits					Loans against Security per contract.	Loans from paper Currency.	Total Liabilities 3+8+10.	Loans	Cash Credits	Bills.	Cash on hand and at Bank.	Government Securities.	Other authorised investments.	Total Investments.	Dead Stock.	Gross Profits (000s)	Net Profits, (000s)	Establishment Expences (000s)	Other Expenses (000s).
				Public	Fixed	Current	Total Private Deposit	Total Deposit Liabilities 4+7															
June																							
1914	375	380	755	589			2071	2762				1020	945	547	2174	448	79	527	30	6983	4802	1507	35
1915	375	369	744	497			3860	4357				998	860	461	1519	1117	136	1253	45	6993	4526	1591	35
1916	375	361	736	520			4471	4991															
1917	375	368	738	770			6770	7540				1515	830	915	3556	1445	164	1609	56	7443	4839	1882	37
1918	375	340	715	863			5095	5958				1820	1352	436	1816	1106	165	1271	58	8252	5190	2104	37
1919																							
1920																							
1921	562	433	995	680			6578	7258	39		7258	1867	2527	993	1360	1117	128	1245	236	23202	13055	6678	3474
1922	562	433	995	1460			5700	7116	88		8111	1930	2899	619	1507	853	125	978	245	27160	14542	8409	4209
1923	562	445	1007	857			7419	8276		800	9283	2162	3763	1143	1501	1088	128	1216	244	29865	15478	9389	4998
1924	562	467	1129	750			7671	8421		200	9750	1579	3334	1158	1560	1515	121	1636	263	32083	15960	10645	5478
1925	562	482	1044	546			7783	8329			9373	1470	3577	488	1746	1579	122	1701	273	31509	14219	11692	5598
1926	562	509	1071	645			7390	8025			9106	1433	2538	733	2090	1719	195	1914	277	32203	14949	12488	4821
1927	562	512	1074	720			7207	7927		400	8677	1629	2975	1546	1089	1670	189	1859	276	32124	15080	12298	4766
1928	562	522	1084	795			7130	7925			9009	2162	2750	1244	1057	1904	272	2176	281	32122	15309	12344	4559
1929	562	532	1094	760			7164	7924			9018	695	2737	624	1400	3016	288	3299	280	32381	15014	12677	4680
1930	562	540	1102	736			7660	8396			9493	1490	2589	375	1804	2656	268	2924	274	31957	14449	13022	4486
1931	562	500	1062	832			6385	7217			8529	1041	2654	459	1103	2759	267	3026	268	28370	11490	12653	4227
1932	562	517	1079	706			6836	7542			8621	661	1901	194	2096	3037	166	3203	261	29419	13751	11473	4195
1933	562	522	1084	644			7412	8056			8700	416	1529	200	1859	4619	83	4702	253	25497	10071	11904	3764
1934	562	535	1097	672			7427	8099			9196	583	1559	255	1897	4155		4155	245	25866	10760	11988	3123
1935	562	547	1109				7909				9018	369	1487	300	1958	4640	46	4687	231	24225	11642	11575	2998
1936	562	550	1112				7879				8991	573	1624	479	856	5231	27	5258	222	24198	10620	10716	2862
1937	562	550	1112				8116				9218	650	1687	599	1343	4632	139	4764		23831	10405	10043	3382
1938	562	555	1117				8151				9268	1098	2176	555	899	4327	44	4374	299	24457	10657	10922	2878
1939	562	560	1122				8784				9906	1070	3098	659	1108	3815	46	3801	135				
1940																							

TABLE X

Imperial Bank of India December 31st

In percentage to Total Deposits

	Capital and Reserves	Public Deposits.	Loan from P.C.R.	Fixed Deposits	Other Deposits	Loans	Cash Credits.	Bills	Govern-ment Securities	Other authorised Securities	Total Invest-ments	Dead Stock	Cash.
1910	21.3												
1911	20.4												
1912													
1913													
June 1914	19.0	22.1				38.3	35.5	20.5	16.8	2.9	19.7	0.2	46
1915	19.3	11.4				22.7	19.7	10.5	25.6	3.1	28.7	1.1	
1916	16.4	10.5											35
1917	10.9	10.2				20.0	11.0	12.1	19.1	2.1	21.2	0.7	45
1918	14.1												
1919	11.3												30
1920	9.6												
1921	13.7	9.3				25.7	34.8	13.6	15.3	1.7	17.0	3.2	18.7
1922	13.9	19.8				27.1	40.7	8.6	11.9	1.7	13.6	3.4	21.1
1923	12.1	10.3				26.7	45.4	13.8	13.1	1.5	14.6	2.9	18.1
1924	13.4	8.9	2.5			18.1	39.5	13.7	17.9	1.4	19.3	3.1	18.5
1925	12.5	6.5				17.6	42.9	5.8	18.9	1.4	20.3	3.2	20.9
1926	13.3	8.0				17.8	31.5	9.1	21.3	2.4	23.7	3.4	26.8
1927	12.8	8.6	4.8			19.5	35.7	18.5	20.0	2.2	22.2	3.3	13.0
1928	13.6	10.0				27.2	34.7	15.6	24.0	3.4	27.4	3.5	13.3
1929	13.8	9.5				8.7	34.5	7.8	38.0	3.5	41.5	3.5	17.6
1930	13.1	8.7				17.7	30.8	4.4	31.6	3.1	34.7	3.2	15.6
1931	14.2	11.1	3.3			14.4	35.5	6.1	36.9	3.5	40.4	3.5	14.7
1932	14.3	9.3				8-7	25.2	2.5	42.2	2.2	44.4	3.4	27.7
1933	13.4	7-9				5.1	18.9	2.4	57.3	1.0	58.3	3.1	23.0
1934	13.5	8.2				7.1	19.2	3.1	51.3		51.3	3.0	23.4
1935	14.0					4.6	18.8	3.7	58.6	0.5	59.1	2.9	24 5 (0.2)*
1936	14.1					7.2	20.6	6.0	66.3	0.3	66.3	2.8	9·9 (0.9)
1937	13.7					8.0	20.8	7.3	55.9	1.7	58.6		13.3 (3.1)
1938	13.6					13.4	26.6	6.5	55.1	0.5	53.5	3.6	6.9 (4.1)
1939	12.7					12.1	35.2	7.5	42.2	0.5	42.3	2.1	11.1 (1.5)
1940													

* Figures in brackets are balances with other banks.

TABLE XI

Imperial Bank of India (Percentage to Deposits)

	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	Average for 1921-22	Average for 1923 1929
Cash.												
March	26.8	22.9	17.1	15.2	16.9	24.5	18.8	12.1	11.9	18.9	24.8	16.5
Sept.	29.0	36.1	37.8	26.1	32.4	45.2	31.8	26.1	30.5	25.8	32.5	32.8
Loans.												
March	19.1	20.1	22.2	22.7	19.2	17.8	18.0	12.7	12.0	9.7	19.7	17.8
Sept.	28.1	17.6	14.5	14.9	14.1	10.6	11.4	12.0	8.8	17.5	22.8	12.2
Cash Credits.												
March	27.1	32.7	37.1	35.0	30.6	34.8	33.2	32.8	35.7	31.4	29.9	34.1
Sept.	22.6	26.3	29.8	34.8	28.5	18.8	24.8	28.1	22.8	28.8	24.4	26.7
Bills.												
March	11.7	10.1	10.5	12.9	16.8	5.9	7.4	16.5	12.8	7.8	10.9	11.7
Sept.	7.8	4.1	4.5	5.8	5.1	4.4	6.2	4.7	3.2	2.4	5.9	4.8
Investments												
March	16.0	11.5	11.2	9.8	14.0	15.5	20.0	22.6	24.1	29.3	18.8	16.7
Sept.	15.4	9.8	12.1	11.5	17.1	18.0	22.5	25.8	32.5	24.0	12.6	19.9

TABLE XII

(Average Percentage to Deposits)

		Imperial Bank	Bank of India.	Central Bank of India.	Punjab National Bank.	Bank of Mysore.
Cash						
1915-20	June		22.0	16.4	16.1	27.6
	Dec.		27.4	16.4	15.7	28.4
1921-25	June	34.2	21.2	16.2	...	...
	Dec.	19.4	20.8	19.4	...	...
1926-30	June	28.3	17.4	...	9.4	15.8
	Dec.	17.2	15.8	...	8.0	10.4
1931-35	June	25.2	17.8	...	5.1	15.4
	Dec.	23.7	14.7	...	6.3	14.4
Loans, Advances Bills.						
1915-20	June	...	82.1	61.7	...	...
	Dec.		81.1	62.4	...	...
1921-25	June	60.0	81.3	64.0	...	...
	Dec.	74.7	78.6	68.6	...	...
1926-30	June	52.6	74.9	...	63.5	77.5
	Dec.	63.4	68.6	...	65.2	77.4
1931-35	June	37.9	58.8	...	60.8	72.9
	Dec.	35.1	51.3	...	63.4	70.0
Investments.						
1915-20	June	...	12.6	...	22.9	...
	Dec.	...	12.8	...	20.3	...
1921-25	June	13.4	17.8	...	...	...
	Dec.	17.1	20.3	...	...	...
1926-30	June	24.9	17.4	...	30.9	23.4
	Dec.	30.2	27.8	...	34.2	25.3
198-135	June	44.5	31.5	...	36.5	30.1
	Dec.	50.9	29.9	...	33.2	35.3

CHAPTER V.

STRUCTURE OF ASSETS AND LIABILITIES

THE structure of assets and liabilities of a banking system is the outcome within certain limits of their mutual interaction. The quantities and character of resources which form the liabilities of banks limit naturally the choice of business which they undertake. But it is also within the power of banks themselves to influence to an extent the volume and composition of their liabilities. Both assets and liabilities in the long run are themselves the reflection of basic economic conditions of a country or region in the determination of which the banking system as such is only one among several factors.

It is usual to speak of the Indian banking system as being composed of three elements. The Exchange Banks conform to one pattern, the basic aims and objects of which are broadly reflected in their structure of assets and liabilities. The Imperial Bank of India holds a special status which is to be largely interpreted in terms of political and historical circumstances. The third constituent is made up of Indian joint stock banks which it is usual to class under one head. As a matter of fact, Indian joint stock banks do not conform to one homogenous type but reveal certain divergences of aims and objects or economic environment which it should be one of our main objects to study. The present chapter is devoted to the study of these three constituents but in the case of the last, it covers very largely those leading banks for which information is easily available.*

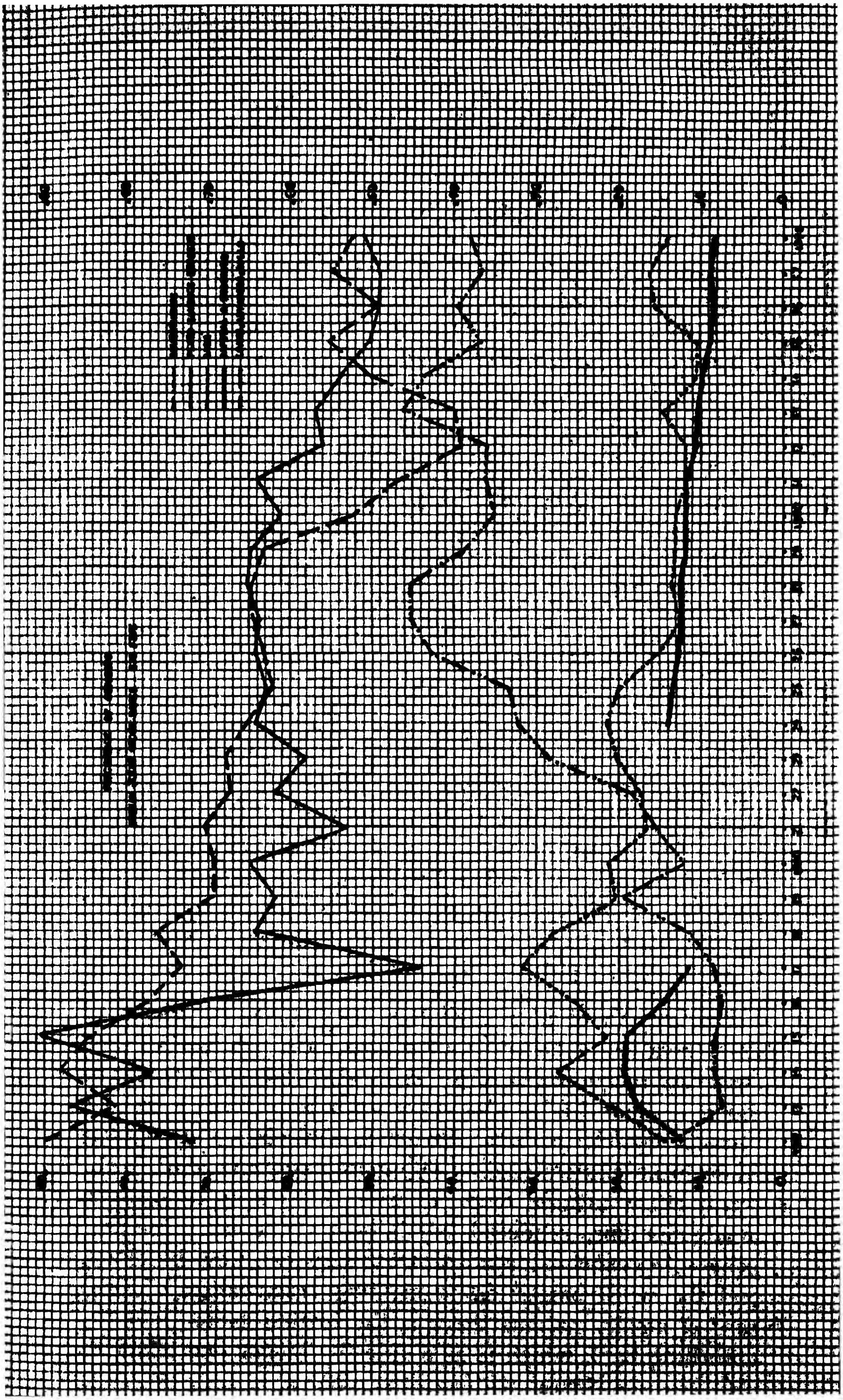
I

STRUCTURE OF LIABILITIES

Capital and Reserves

The capital and reserves of a bank perform a dual function. They serve as a guarantee fund to the creditors

* References through-out Section I are to Tables XIII and XIV and in the case of the mperial Bank Tables IX to XII.



of a bank, since in case of failure, losses must in the first instance fall on capital and reserves. To that extent, a high proportion of capital and reserves is the basis of public confidence in a bank. Secondly, they form the fixed part of the resources of a bank and as such may be found useful for certain types of investments for which other borrowed resources are not deemed so eligible.

This proportion is the outcome of diverse factors. They may be stated in general terms as—Bank Policy; Banking Laws; Bank-Amalgamations; Causes influencing the normal size of deposits; Monetary changes which ensue in appreciable inflation or deflation and which, though they act on deposits are so important that they deserve a separate place in our analysis.

The banks themselves have it in their power to fix this proportion by estimating the volume of business they aim at or aspire to build and raising their capital accordingly. It has been a serious and well-founded complaint against Indian Banks that many of them start on their career with capital which is altogether insignificant for the type of business and responsibilities which a bank is held to undertake. The more flagrant type of abuse has now been prohibited by the Indian Company Law of 1936 which prescribes a minimum capital of Rs. 50,000 and a statutary accumulation of reserves so as to raise the owned funds by a further Rs. 50,000 in a short period.

The growth of banks whether by natural expansion or amalgamation tends to lower the ratio of capital and reserves. Economies of large scale are to a certain extent as much evident in banking as elsewhere. Growth in size attracts confidence and confidence attracts resources and so on in an endless chain. The more expensive staff at the top is either utilised more intensively or, as in the case of amalgamations, rendered partially superfluous. The less profitable branches or lines of business can now be closed and the work passed on to existing organisation. In the case of amalgamations there is the further factor that the absorbing bank which is as a rule the bigger one offers its

shares which have a greater market value in exchange for the issued capital of the smaller bank. There takes place in this way a reduction in the amount of the nominal capital added to the capital of the bigger bank. Sometimes, indeed, amalgamations take place by discharging the shares of the small bank in cash or by the allotment of government stock.*

The proportion under discussion depends as much on the absolute size of deposits as the absolute size of capital and reserves. It is within the discretion of banks to determine at least initially, the size of the latter. But the factors which influence the size of the former are very largely beyond the power of the banks to determine.

Holland is a very arresting example of how a high proportion may be the outcome, not of the largeness of capital and reserves, but of the relative smallness of deposits. In India also, factors are at work which on the balance tend to keep down the volume of deposits. Ignorance and illiteracy make the cheque habit the exception rather than the rule. Hoarding or direct investment whether in industries or money-lending is preferred to the use of banks as custodians or intermediaries. Postal money orders are a more common medium of transfer of funds while postal cash certificates and postal savings accounts attract not a small part of the savings of the community. Hence, the volume of deposits, small as it is in relation to the area and population of the country, tends to be small also in relation to the capital structure of banks.

No factor we have analysed till now can compare in its importance, however, with inflationary or deflationary movements and the rise and fall of prices. In such times, capital and reserves remain unchanged while the volume of deposits is subject to large and rapid alterations. Even when further capital is called and profits diverted into

* The influence of this factor is well illustrated in the case of the British banking systems United Kingdom.

	1897	1910	1914	1919	1922	1930	1938
Proportion present of capital and Reserve to Deposits and Notes (including Bank of England) ...	15.3	12.8	9.7	6.0	7.0	7.5	6.7
" " (Excluding Bank of England) ...			9.9	6.0	7.2	8.4	7.5

Bankers, Insurance Managers and Agents Magazine. October 1939, pp. 513-14.

reserves, the aggregate is hardly able to keep pace with inflation. When inflation ultimately gives way to its deflationary sequel, bank-failures and net withdrawals of cash are the only factors exerting to bring deposits into some adjustment with the fixed capital structure. The more usual course of events is that the proportion falls in times of rising prices and remains steady in times of falling prices. The uncertainties of inflation and deflation, their uncertain degree, duration etc., make bank managements naturally unwilling to undertake in such times any hasty alterations in the fixed capital structures of banks.

The force of this factor is well illustrated by the banking systems of those countries which have passed through great inflationary and deflationary phases. In France the pre-war ratio of 20 per cent. fell to 8 per cent. by 1929 *i.e.*, till the currency stabilisation of 1928. In Germany, the pre-war ratio of 30 per cent. deteriorated to 8 per cent. by 1929. Many other countries show evidence of the operation of the same forces—although not on the same scale.*

The slow progress of the banking habit and growth of deposits in the 19th century in India has been already recorded elsewhere.† Even the Presidency Banks, with all the prestige of government to support them, found it necessary to depend for a substantial part of their working resources on their capital and reserves. As high as 56 per cent. and more of their private deposits in 1870, their capital and reserves were still 30·2 to 43·2 per cent. of deposits during the interesting episode of the nineties.

The present ratio of the Imperial Bank is partly the outcome of the great inflation of war years. Before the Great War, the ratio used to be in the neighbourhood of 20 per cent. and even above. The war with its grave inflation

* Percentage of Capital and Reserves to Public Liabilities.

	1913	1929		1918	1929
Netherlands ...	53	28	France ...	20	8
Germany ...	30	8	U. S. A, (Member-banks) ...	19	14
Switzerland ...	22	16			
England ...	10	7			

Pp. 27-28. League of Nations. Commercial Banks 1913-29.

† See pp. 4-8; and Tables XXI, XXII.

caused a rapid fall till it was less than 10 per cent. by 1920. The increase of capital in the amalgamation of 1921 on the one hand and the great expansion of deposits consequent on the creation of its 100 statutary branches on the other seem on the whole to have balanced each other at a steady level of about 13 to 14 per cent. The great deflation of post 1929 years has not affected this proportion.

In a growing banking system, the factor which influences the proportion most is naturally the growth of deposits caused by expansion of branches or new places of operation. The Allahabad Bank of India, the oldest among existing "Indian" joint-stock banks had a capital of 3 lakhs in 1870 when the Presidency Banks had a capital and reserves of 361 lakhs. In 1870, *i.e.*. 5 years after its establishment, the proportion of owned to borrowed resources was as high as 78 per cent. With the growth of deposits, the proportion fell to 22·8 in 1880 and by the turn of the century, it diminished to a mere 6·5 per cent. The Punjab National Bank was launched in the middle of the remarkable nineties with capital and reserves which amounted to less than 2 lakhs only by 1900. At that time, the proportion stood at 14·1 per cent.

In the early years of their career, just before the Great War, the Big Five of Indian joint-stock banks maintained a ratio of 12 per cent. This ratio is best understood in the light of the previous history of Indian joint-stock banks of A Class in which they are included. Till 1906, when the Swadeshi movement became active, these banks had maintained a ratio between 16 to 18 per cent. The Swadeshi wave, reinforced by steadily rising prices, caused an increase in deposits and lowered the ratio to less than 11 per cent. in 1910. In 1912, the year before the banking crisis broke out, the ratio of the Big Five was 12·8.

During the War, extension of branches and inflation acted together to affect this ratio adversely. In the case of Class A banks, the ratio fell from 14·5 per cent. in 1915 to 12·9 per cent. in 1919. The figures for the Big Five are 10·3 and

10·6 per cent. in spite of substantial additions to their capital and reserves in the closing years of the war.*

The steady deflation of 1922-29 was more than counter-balanced by extension to new places and creation of new branches. Class A banks maintained a steady ratio of 16 to 18 per cent. The Big Five among whom the Central Bank of India recorded a great accession to capital and reserves on its amalgamation with the Tata Industrial Bank, improved and maintained their level at about the same proportion as the Imperial Bank *viz.*, 13 to 14 per cent. The situation changed strikingly after 1929 when the great spate of expansion added so enormously to their deposits that the proportion fell down to 9 per cent. by 1938. Class A banks recorded a fall to about 14 per cent.

Class B banks present an altogether different case. Insignificant capital and reserves mean ipso facto insignificant capacity to attract deposits. It is hardly surprising that such banks should have to depend for their working capital more on owned than borrowed resources. Hence, the proportion, in their case has been always very high much more generally than 30 per cent. It shows also much less fluctuation for the simple reason that their growth is always more in numbers than in size.†

The general drift of our analysis may be stated in this manner. The capital and reserves of a banking system may not be judged as adequate or inadequate on any a priori grounds. While a certain minimum size may be always postulated on the basis of the wealth and circumstances of a country, their ratio to deposits is determined by many factors among which the policy of bank management is only one and by no means the most powerful. Among the other factors, a high place must be assigned to the past history of a banking system and world-wide forces like inflation or deflation. The desirable level is to be decided relatively to the special circumstances of each country and particularly, to each phase of growth. An effort to set up rigid standards on this subject should

* See pp. 185; 192; 212.

† See pp. 21-23.

have to take account of so many complicated and special factors as to make it nugatory in practice.

Deposit-Liabilities of Banks*

The bulk of the resources which a bank employs are borrowed from the public. This is indeed one of the main, if not the main, characteristic which distinguishes banking from ordinary money-lending. The quality, character, behaviour, etc., of these resources are therefore an important key to the interpretation of the inner character of a banking structure.

By far and away the most significant fact about these borrowed resources is their distribution between time and

*	Aggregate Deposit (calender year-end)	Scheduled Banks Deposits (In Lakhs).	Percents of 2 to 1
1935-36	245,16	217,72	88.8
1936-37	257,48	229,97	89.3
1937-38	......	241,81	......
1938-39	......	237,87	......

Proportion of Time and Demand Deposits.

Ratio of D-D to Total Deposits.

		1913	1920	1926	1929	1935
England and Wales	...	...	63.8	57.8	54.1	54
U. S. A. (N. - Bs.)	...	91.1	78.3	58.8	56.3	54
France (Principal)	...	98.0	95.5	96.7	92.7	97
Germany (Berliner)	...	58.6	76.7	50.1	41.8	45
Netherlands	...	55.2	69.1	52.1	47.6	...
Switserland	...	28.5	87.6	81.0	29.5	...
India Scheduled	...	...	...	...	...	54.7
	1912					
Big five ...	27.9	13.1	34.8	33.4	35.0	49.1

Ratio of Current to Total Accounts.

	London Clearing Banks	U. S. Commercial Banks.	France 6 Prin. Bank.	Germany 5 Banks Nov. figure.	Indian Scheduled Banks.
1929	54.1	55.9	92.7	41.8	......
1930	52.9	......	......	......	......
1931	52.7	53.4	93.7	......	......
1932	49.5	53.3	95.2	......	......
1933	51.8	56.2	94.8	......	......
1934	51.8	55.9	95.0	......	54.6
1935	53.8	......	......	45.8	......
1936	......	......	......	......	......
1937	......	......	......	46.8	54.8
1938	......	......	......	46.9	54.6

demand deposits.* The only statistics available on this point relate to the Big Five or Seven of Indian joint-stock banks and, for a few recent years, the Scheduled Banks in which the former are of course included. The Scheduled Banks represent almost 90 per cent. of the organised banking power of the country. The Big Seven claimed in the same years 30 per cent. of this banking power. Figures relating to these banks may therefore be taken as representing fairly general conditions in the country.

These figures indicate that demand deposits formed in recent years more than half of total deposit-liabilities. In the case of our Big Five, the proportion has been a little less, 50 per cent. in fact. This proportion is almost as high as in many advanced countries like United Kingdom, the United States etc. Even though allowance has to be made for differences in definitions of time and demand deposits, the figures are nevertheless arresting in themselves. Evidently, they demand some scrutiny for their proper interpretation. A high proportion of demand-deposits reflects sometimes a highly developed banking habit. But in certain other circumstances, as in France for example, it is indicative merely of the smallness of time deposits.

In the first place, the use of cheques in India is more or less limited to five hundred and odd towns and cities only. A good proportion of places with a population of 20 thousand and over, a fair proportion of places which have populations between 10 and 20 thousand and a very few places with population under 10,000—these are the territorial limits of the banking habit in this country. An analysis of currency habits indicates how the use of notes and rupees predominates in certain parts of the

* Certain qualifications have to be borne in mind in interpreting these terms and particularly in making comparisons. In certain countries (e.g. U. S. and England) deposits for three months and more only are returned as fixed deposits. In other countries, the minimum period may be as short as one month or even one week. In India, fixed deposits are rarely accepted for less than six months. But the figures in the text are compiled on the basis that whatever each bank so describes is fixed deposits. Again, it should be borne in mind that in times of difficulties respectable banks do not insist on their legal right but allow even fixed deposits to be withdrawn before due time. Insistence on legal rights is apt to aggravate fear and suspicion. Finally, sometimes over draft is granted on the security of a fixed deposit. In this case, the procedure is tantamount to conversion of a fixed deposit into a current deposit.

country while other means of payment are in vogue in other parts.* The high proportion of demand deposits in our banking resources is therefore representative only of a small India, hidden and overshadowed by an immense India around, still addicted to primitive monetary habits.

Secondly, this high proportion seems to be only a recent occurrence, particularly of post 1929 times. It is symptomatic not so much of any unusual growth of demand deposits as of an arrest in the growth of fixed deposits. Before the outbreak of the Great War, fixed deposits of the Big Five used to be as high as 70 per cent. and more. The War with its great inflation initiated a change and till 1920, the proportion fell with marked rapidity. The percentage continued stable at about 60 to 65 till 1925 but a rapid decline set in thereafter. Between 1926 and 1936, the fixed deposits of the Big Five rose from 30 to 34 crores only but demand-deposits mounted from 17 crores to 35 crores. Several causes have been at work to diminish the importance of fixed deposits in the banking system.

Since 1920, Postal Accounts and Cash Certificates have competed severely with fixed deposits as an alternative outlet for investment. Hardly 1/9th of private deposits of all banks in 1920, they grew to be more than 1/2 in 1934. Apart from the confidence which post offices must always inspire in a country like India, the course of interest-rates in post-war and particularly post 1929 years has been no inconsiderable factor in this development.†

The remarkable and growing popularity of life insurance and preference for direct investment in stocks and debentures must tend in the same direction. Funds which used to appear formerly as fixed deposits now pause for a while as current deposits on their way to absorption in permanent investment. Preference for direct investments of this kind has been no mean factor in the surprising bulge of

* Pp. 251-55.

† Chapter III. RATES OF INTEREST OF POSTAL SAVINGS BANK ACCOUNTS.
(1) Three pies for complete sum of Rupees five for one month upto 31-3-1894, i.e. 3¾%.
(2) Three pies for complete sum of Rupees six for one month from 1-4-1894 to 31-6-1905
(3) 3% per annum from 1-7-1905.
(4) 2½% per annum from 1-11-1933.
(5) 2% per annum from 1-7-1936.
(6) 1½% per annum from 1-12-1938.

current deposits which is such a feature of the French banking system.

The relative rates obtainable on current and fixed deposits and on other forms of investment have a direct bearing on this distribution. The long-term rate was falling between 1920 and 1927 but it still remained at a high level of 4·4 per cent. It rose subsequently, reaching 5·7 per cent. in 1932. Throughout these years, rates offered on fixed deposits were unusually high even in the case of exchange banks and the Imperial Bank of India. As we have recorded, the fixed and saving deposits of the Big Five accounted for about 65 per cent of the total till 1930-31. The situation changed radically after 1932. The long-term rate declined from 5·7 in 1932 to 3·55 in 1938. The short rates fell even more precipitately.* From 1931, the proportion of fixed and savings deposits for the Big Five began to fall steadily. By 1938, it reached the unprecedentedly low level of 50 per cent.

The average size of accounts, their degrees of activity and the aggregate number of depositors have no doubt a direct bearing on the profits of banking business. They have also a deep significance for the strength and stability of a banking system. To extend exploitation from classes and places of larger banking potentialities to those with smaller banking potentialities is not a matter of mere economy in expenditure or technical organization. It means sometimes the exposure of the banking system to all irrational and tidal changes of moods which sway the mass of humanity. It is more than probable that the extraordinary increase in the number of depositors of commercial banks between 1915 to 1930 was no mean factor in the collapse of confidence which occurred in the United States in 1932-33. In a country like India, the infiltration of the masses into the banking system is fraught with even more incalculable dangers.

Direct statistics on these matters do not exist in this country. We have noted that the proportion of places with

* See pp. 51-53.

banking facilities has altered very much in favour of smaller towns with less than 10 thousand population. Since creation of branches has been a more important factor in the growth of deposits than extension to new places, it must also tend in the direction of bringing into the orbit of the banking system classes of smaller banking potentialities. In his testimony before the Hilton-Young Commission, the Chairman of the Bengal National Bank referred pointedly to the great growth in small-sized savings bank accounts which proved very expensive and troublesome to manage.*

It is even more difficult to speak of the social strata from whom our depositors are drawn. We can merely draw on the impressions from time to time of leading men in the banking world and trust to the imagination of the reader to complete the picture. The Secretary of the Bank of Bengal averred before the Fowler Committee of 1898 that the wealthier ryots and zemindars rarely deposited their money in banks.† The situation had apparently changed favourably by 1911-12. In his evidence before the Chamberlain Commission, the agent of the Allahabad Bank described Indian joint stock banks as drawing their funds from "the artisan, babu, pleader and cultivator." While expressing fears about "mushroom banks operating all over the country," he described the depositors of respectable banks as professional people, doctors, lawyers, government servants, etc.‡ The Chairman of the Bengal National Bank giving his evidence before the post-war Hilton-Young Commission of 1926 reported that a movement from hoarding into banking was visible even among peasants and cultivators.¶

* Q. 7933-38. Evidence, Hilton-Young Commission.

The Bengal Provincial Enquiry Committee records as follows with reference to the Benga. Circle figures of the Imperial Bank for the quinquennium ended 31st December 1929s "Deposits in current accounts and fixed deposits have somewhat declined and those in savings banks have increased during the period, but the number of holders of current accounts hae increased much more than that of savings banks depositors. Another noticeable featurr is that the average amount for which each cheque is drawn has declined while the numbe of cheques drawn on each account has increased, specially after the abolition of stamp-duty on cheques". Pp. 39-40.

† Q. 8613; 8616.

‡ Q. 8663; 8625.

¶ Q. 7933-39.

II

STRUCTURE OF ASSETS*

There cannot be an ideal distribution of assets which can hold true for all times, for all countries or even for all banks in the same country. The financial and economic structure of each country prescribes in a broad manner the character of resources which banks attract and the type of investments in which their funds find outlet. Within the limits set by the financial and economic structure, each bank and banking system have to strive to reach a balance, often a very delicate one, between a maximum of profit and a maximum of liquidity and elasticity. The factors which underlie the financial and economic structure are themselves liable to large cyclical and secular changes amidst which eternal vigilance and adaptability are the only key to success in banking.

British Clearing Banks.
(Percentages of Deposits.)

	1929·	1935·	1936·	1937·
Cash	10.6	10.5	10.0	10.2
Call and Short Loans ...	7.9	7.1	7.1	6.8
Discounts	13.2	14.6	15.5	13.0
Investments	14.8	30.2	28.5	27.2
Advances	55.5	37.3	39.8	42.6

4 French Deposit Banks.
(Percentages of Deposits)

	1929	1935	1936	1937
Cash and at Bank ...	......	20	19.5	......
Discounts	......	58	61	......
Loans and Advances ...	......	35.5	31.0	......
Investments and Premises	......	1.3	1.2	......

5 German Banks.
(In Percentages of Deposits).

	1929	1935·	1936·	1937	1938
Cash ...	......	3.5	......	2.5	......
Discounts ...	......	45.6	......	55.7	......
Loans ...	......	44.9	......	45.6	......
Securities ...	......	8.9	......	17.7	......

* The percentages usually used in the analysis of assets and liabilities of banks in such discussions have to be accepted with certain qualifications. (1) Collecting bankers are apt to credit cheques before the drawee bankers have debited them. If in order to rectify this double counting in the figures for aggregate deposits .cheques in course of collection were subtracted, the deposits in England, it has been estimated, will have to be reduced by 3 to 4 per cent. (2) The proper place of sight deposits with foreign banks and foreign currency does not yet seem to have been fixed. (3) Under a loan account, £1,000 of which only 600 have been availed of appear as an asset. But under an overdraft account, £400 only are shown as an asset.

· November.

5 Banks, Holland.

(In Percentages of Deposits).

	1929	1933	1937
Cash ...	69.4	139.2	131.1
Bills ...	33.7	101.9	135.6
Advances against securities ...	58.8	41.6	72.9
Investments ...	22.9	49.7	29.5

Capital and Reserves as P. C. of deposits=95; 173; 122.

U. S. A.

(In percentages of deposits ex-inter-bank).

...	1929*	1931*	1933*	1934*	1935†	1936†	1937†
Cash	8.6	9.5	11.6	16.7	15.8	13.4	10.9
Bills	...	...	...	...	...	...	...
Investments	34.9	41.0	50.6	54.7	67.9	69.3	62.3
Loans and Advances ...	77.7	70.5	55.7	45.6	46.6	48.1	47.0
Premises	3.9	4.2	4.4	3.8	...	...	...

* End of June National Banks. League of Nations. Commercial Banks. 1936, p. 201

† Annual Averages. Member-banks; Federal Reserve Banks. December 1938, p. 1041

France, Commercial Banks.

(Percentages of Deposits.)

...	1936 Dec.	1937 Dec.	1938 Dec.
Capital Reserve	11.1	10.3	9.3
Time Deposits	7.2	7.4	7.0
Sight Deposits	92.8	92.6	93.0
Cash	10.4	10.9	10.7
With Banks and Correspondents ...	10.6	13.3	12.0
Bills and T-Bills	59.0	57.3	61.6
Advances and Participation... ...	30.5	28.7	24.9

Indian Scheduled Banks.

(In Percentages of deposits only).

...	1935	1936	1937	1938
Cash in hand and at Bankers ...	13.5	12.9	12.9	......
Bills and Loans	3.2	5.0	5.9	......
...	33.9	38.5	41.4	......
Investments	51.5	55.1	50.3	......
Fixed Assets	......	......	......	......

All Scheduled Banks.

(In Percentages of deposits only)

...	1935-36	1936-37	1937-38	1938-39
Cash	17.3	14.0	12.8	......
Bills	2.3	2.5	1.5	
Advances and Discounts	42.0	43.4	49.4	......

The Indian Big Five.

(Percentages based on Capital, Reserve and Deposits except for 1928)

	1916*	1917*	1927	1928†	1930	1934	1935	1936
Cash ...	24.7	25.0	13.8	11.6	11.8	14.0	21.1	21.1
Bills and Loans	65.0	71.4	55.3	2.0 56.7	48.8	37.7	44.2	40.4
Security ...	9.2	11.4	36.0	24.0	37.0	45.3	40.0	38.5
Fixed Assets ...	1.9	1.5	3.5	3.5	4.0	4.1	4.4	4.0

* India, Central and Allahabad only; † The Big Five and Peoples Bank of Northern India. Percentages based on current and deposit accounts only and therefore relatively larger. Banking Inquiry Committee Report, p. 408.

Loans and Advances

As indicated in our analysis of the structure of interest rates, returns on short-term investment tend to be relatively more attractive than on long-term investment. This should by itself make investments in short loans particularly sought by banks. As a matter of fact, the proportion of loans and advances to total liabilities does not appear to be much higher in India than in some other countries. Indeed it is even difficult to speak of a normal volume of loans and advances for banks in India. It is of much more practical importance to note the large fluctuations which occur in this volume and to seek their causes. It is probable that in these fluctuations, the relative position of short and long rates is much less decisive than the differential between the two. In India, as observed already, a change in the trend of long and short rates rarely takes shape as a reversal of the permanent relationship between them. Its effect is seen largely in widening or narrowing the gap according as rates are tending to be stable or moving up and down. In the war years 1916 and 1917, when short rates were rising faster than long rates, the proportion of loans and advances of the Big Five to their deposit-liabilities rose as high as 70 to 80 per cent. In the more stable years 1922-1929 when the long-rate was moving on a high plane, the proportion declined to 62 per cent. In the years after 1930, when with stagnation of trade and industry short rates actually fell below long, the percentage of loans and advances reached much lower levels round 40 per cent. and showed signs of recovery only after 1937.

These figures do not convey adequately the extent to which banks invest in and profit by short-term loans. The percentages are based on figures which are not averages for the whole year but relate to a particular date generally December end. On account of the predominance of agriculture in India, short-term finance has a highly seasonal character. It may, therefore, be expected that the assets of banks should show large fluctuations according to the

time of the year. As a matter of fact, however, such a strongly seasonal trend holds true only of the Imperial Bank of India. The balance sheets of the other big joint-stock banks do not show seasonal variations which could be compared with those of the Imperial Bank.

September and March or April represent the two extremes of the demand for seasonal accommodation.* Unfortunately, comparative figures on this point are available only for June and December. June may be described as lying midway in the transition from conditions of stringency to conditions of slackness while December represents the antipode of June. Although the contrast between June and December is not as sharp as between March and June, it demonstrates sufficiently the point at issue.

In the two five yearly periods of 1921-25 and 1926-30, the proportion of cash to deposits between the months of June and December shows as large a variation as 15 and 11 per cent. in the case of the Imperial Bank. For four among the Big Five, the variation is barely 2 to 3 per cent. It is only with the onset of the depression and stagnation of 1931-35 that the Imperial Bank has a cash-ratio as stable as those of other banks.

The reverse side of the picture is represented in the movements of Loans, Advances and Bills. For the first two periods, the advances of the Imperial Bank show an average increase in the proportion of the order of 14 and 11 per cent. for the month of December against corresponding counterbalancing movements in cash. The movement in the case of the other banks are small and insignificant. In all cases, investments move independently of changes in cash or advances ratios and record a definite secular trend irrespective of seasonal conditions. The significance of this point will be elaborated presently.

We have observed above that loans and advances of Indian banks do not bear a much higher proportion to their deposit

* Pp. 93-95; and Table XII.

liabilities than elsewhere.* This suggests that the exploitation of the profitability of short-term investment is impeded either by the shortage of credit-worthy borrowers or by the attractiveness of some other forms of investments. A paucity of borrowers who are willing and able to offer security acceptable to banks is not a problem special to India. It is the other factor which requires analysis here.

The profitability of short term loans in India, which we have analysed elsewhere, is an average profitability. The lender who is eager to reap the high returns of the busy season has to take into account the risk that his average profit may fall very much if the slack season fall of rates should turn out severer than expected. Investments in time loans, renewable according to circumstances offers a lucrative alternative whose steady returns are not an inadequate compensation for loss of liquidity. The rates on such loans are stated to be about the same as in England or Scotland, 5-5¾ per cent.†

Secondly, in discussing the proportion of loans and advances to total deposits, we must note that the attraction of short-term, seasonal loans is not the same to all banks. If seasonal loans are more profitable than equally safe long-term loans, there are other kinds of loans which rank higher in profitability than even seasonal loans. Mortgage loans offer a type which is least shiftable and at the same time most lucrative. In the absence of mortgage institutions, many banks in this country, there is ground to believe, are tempted into this field. The high proportion of fixed deposits and among them a high proportion of those fixed for one or two years or even longer may be an inducement to such loans. This seems to explain how even in the post-Crisis years 1931-1936, certain banks, *e.g.*, the Punjab National Bank and the Allahabad Bank of India, carry loans

* Loans and Advances.

(As Percentages to Deposits.)

	1929	1931	1935	1936	1937	1938
United States	77.7	70.5	46.6	43.1	47.0	......
England	55.5	......	37.3	39.3	42.6	...
France	......	......	33.5	31.0	......	......
Germany	......	......	44.9	......	45.6	......
Indian Scheduled Banks	......	......	33.9	35.5	41.4	......
Big Five	61.3	45.6	42.7	43.9	50.5	......
All Scheduled Banks ...	......	......	42.0	43.4	49.4	......

† Chamberlain Commission. Vol. II. Appendices, p. 614.

and advances at the surprisingly high level of about 60 per cent.

Loans to Money Markets*

After cash, loans to the money market are regarded in all advanced banking systems as the next best protection of 'liquidity.' They have the advantage over cash that they earn some return. In London, the rates on call-loans and discounts tend to fall almost as low as deposit-rates. In the United States, rates on call-loans and loans on short-term government obligations are generally below the Federal Reserve discount rate which represents the price banks have to pay for funds from the F. R. System. Rates on commercial paper and time loans to the stock exchanges are well above the F. R. Bank Rate.

Loans to the money market fall under three categories—call loans to the bill-market, call and time loans to stock-exchanges and finally loans between the banks themselves. The extent to which the available volume of short-term funds is used for one purpose or another has itself a deep significance for the economy of a country no less than for the stability and character of a banking system.

It is generally presumed that the creation of bills and a bill market in India is a pre-requisite of a sound commercial and central banking system. As a preliminary step, therefore, it is necessary to estimate the potentialities of such a development in our present conditions. Three questions have to be answered in order to reach conclusions on this point. In the first place, it is necessary to ascertain the basic conditions which give rise to bills and the extent to which they are present in this country. Secondly, we have to inquire how far the existence of bills implies automatically the services of brokers and dealers to deal in them. Finally, the causes and the extent of the desire of banks either to invest their resources in bills or offer their funds for business in bills have to be taken account of.

(1) It is a self-evident principle of all exchange that no place or country can in the long run buy more than it sells.

* See pp. 263-65; 392-94.

But because of territorial specialisation in production and the consequent roundaboutness of trade, the equality of credits and debits may not hold good as between two specific places or with reference to any particular span of time. When a trade in bills develops *i.e.*, these titles to debts are concentrated in a few hands, debits owed to whomsoever in the wide world can be used to satisfy credits in favour of persons in the same place. Apart from rendering unnecessary in this manner movements of currency or gold to and fro, bills as objective expressions of the need for funds enable temporary surpluses in certain places to be employed to meet temporary needs of other places. A bill market thus serves to equalise the flow of capital over space or time and thus prevent wide fluctuations in interest-rates.

The need to offset credits and debits which ensues from the indirecetness of all modern trade is common to India and all other countries. But territorial disparities in the supplies and needs of working capital caused by the seasonal factor are of such outstanding importance in this country that some description of their working may not be out of place.

When the Rangoon rice crop matures, advances in anticipation of disposal have to be made to the Burman cultivator from December to March. Cotton seeds and early wheat of Bombay and Karachi and the spring crops of Northern India which are the staples of trade in the great markets of Lahore and Cawnpore require to be financed in the same manner between November to March and between April to May respectively. The Calcutta jute crop has its demand for finance concentrated from July to October.* Of course, the quicker the transport of goods and disposal to the final customer, the less is the burden of holding stocks and financing. So far as domestic consumption is concerned, agriculturists and non-agriculturists have perforce to share the burden of holding stocks till such time as their depletion makes room for the output of the next season.

The aggregate of funds to be paid to the producers or in other words, the value of stocks to be held in anticipation

* Report of the Controller of Currency. P. 86. 1921-22.

of the demand of consumers runs into large figures. 30 to 40 per cent. of the total value of cotton crops raised in certain areas and estimated at 10 to 16 crores was reported in the early thirties of the present century to have been directly financed by the Imperial Bank, government treasuries, currency railed out of the currency office and that imported by private agency. In the case of jute, out of a crop valued between 50 to 55 crores in the late twenties, government treasuries and the Imperial Bank alone are estimated to have financed something like 30 to 40 per cent.

While a bill market may serve as a valuable connecting link between credits and debits and between areas of surplus and deficit capital, it is by no means the only intermediary available for the purpose. As banks have grown and extended their branches far and wide, they have tended to supplant the domestic bill market in many countries. Historically, it will be found that bill markets have established themselves in those times when banks were highly localised in their business or in those countries where branch banking is not allowed by law. In India, there are as yet no restrictions on the creation of branches. Direct discounts and collection of bills by bank branches must therefore militate against the rise of a bill market on the scale familiar in some other countries.

As for bills themselves, they serve no doubt as an excellent basis for the grant of credit. A bill is in itself only a legal evidence of indebtedness between persons but its excellence as an instrument of financing trade and commerce lies in three important qualities—its simplicity, the short and definite period within which it matures and the guarantees of the acceptor, drawer and endorser attached to it. When a seller of goods wants immediate payment for the furtherance of his business but the buyer must have time to dispose of the goods, other persons or institutions are glad to step in and discount the bill *i.e.* make the required advance on it with due deduction for interest.

It is clear that the bill will have its vogue as the basis of credit only so long as other forms of advances do not prove cheaper and safer. As a matter of fact there has been

a recent tendency to prefer the overdraft to the bill as a means of raising finance from banks. From a purely logical point of view, there is no reason why the overdraft should involve more formalities or be less certain of repayment on an appointed day or have less dependable security behind it then a bill. Apart from incidental expenses like stamp duty, acceptors' commission, taxes, etc., it lies in the power of the banks themselves to decide whether one form of advance shall be cheaper than the other according to the rates they quote.

(2) There will still remain some scope for bills and a bill market. Many traders lack the requisite standing with banks to have overdraft facilities or to draw bills which may be directly discounted. Such traders find in bills as compared with bank-guarantees a more convenient document on which a third party, the bill-broker, may be induced for a modest commission to add his guarantee by endorsement and which may thus be made acceptable to banks.

To the function of bill broking, pure and simple, the bill brokers find it necessary and profitable to add another function, that of the dealer in bills. For banks are not always able or willing to take up all bills on offer. They insist on high quality and have a special interest in those bills which are admissible for rediscount at the central banks. Besides, according as the surplus of funds they have varies, they vary also the quantities and maturities of the bills they discount. This means that there must exist a bill-market which holds on the one hand quantities of bills which fall short of banking standards or exceed the temporary needs of banks and on the other, judges, grades and classifies bills so as to supply at short notice parcels of bills which conform exactly to bank requirements. For reasons of economy, the bill-broker prefers to act as a holder of such stocks also.

(3) To discharge the function of bill-dealer efficiently, the broker-dealers must have adequate funds to meet all the varying phases of the trade. They can and do engage in this business with their own funds. But as in all other

trades, temporary needs of working capital have to be met with temporary funds. In other words, efficient trading in bills presupposes ability to raise funds, when required, at rates which are sufficiently below the market rate of discount to give an adequate profit margin to the dealers. In many countries, loans to the stock-exchanges are so much more attractive that banks are unwilling to place any large volume of funds in the bill market. For quite different reasons, it is probable that banks in India have no such surplus funds to lend for this purpose. In India, the surplus of bank funds when available is a seasonal and not a steady surplus. Even when banks seek bills for themselves, they naturally prefer those which mature at specific busy times of the year and the volume of such bills is inevitably very limited.

Even in these circumstances, more funds could be released for the bill business if banks were enabled to lower their cash ratios. But this is feasible only when funds placed in the money market can be withdrawn or replaced with funds from some other source. The bill market, on its part, could grow only if there is a dependable supply of funds from one source or another and at rates which enable steady business.

Till the recent establishment of the Reserve Bank of India, the only alternative source of such funds was the Imperial Bank of India. Unfortunately, commercial banks in India have been inclined by tradition to look on the Imperial Bank more as a competitor than as a friend in need. Public rumour also was apt to associate aid from such a rival with embarrassment and difficulties rather than normal banking operations.* The banks had even a grievance against the Imperial Bank in its alleged privileged position which enabled it, according to them, to undercut its rivals.

The Imperial Bank on its part took a commercial view of its position and never sought to define the relationship between its rate for demand loans and its hundi rate.† The hundi rate was sometimes higher and sometimes lower than

* 12268; and Q. 12253-60; pp. 508-09. Appendices. Hilton-Young Commission.

† Pp. 68; 93-95.

the other rate. No discrimination in rates was made in favour of bank-endorsed bills as compared with bills endorsed by private parties. It is no surprise that in these circumstances banks preferred to raise demand loans against securities since the period at least for which a loan is to run is within their discretion.

With the establishment of the Reserve Bank of India, the situation may now be expected to change in an important manner. With the lure of profits out of its way, the Reserve Bank can devote itself to the creation of a stable and well-articulated rates-structure. By maintaining an appropriate margin between the discount-rate and the loan-rate it may give a powerful stimulus to the desire of banks to acquire bills and bring into existence an outside market in bills.

But although direct investment by banks in bills might stimulate the creation of bills, it is doubtful whether banks will be inclined to offer loans to brokers and dealers for such business. Since under our arrangements, banks are to have direct discount facilities at the Reserve Bank, they have much less need of loans to the money-market recallable at short-notice. London banks feel such need because on account of historical circumstances, they have no direct but only an indirect access to the Bank of England through bill-brokers and discount houses. Indian banks will naturally prefer to absorb for themselves as large a quantity of bills as possible—taking care to maintain a large proportion of rediscountable bills. In other words, the market for bills which are not bankable or are in excess of what the banks can absorb seems to have a doubtful future in this country.

The bill of exchange in the form of hundi has been known and used in this country from times immemorial. Several causes, many of them of recent origin, have however retarded and even diminished the growth of this most valuable instrument of commerce and credit.

In the first place, the mudatti hundi or usance bill has become a very expensive instrument of finance on account

of heavy stamp duties which governments have imposed in the interests of revenue. Calculations show that the levy may vary from ½ per cent. and more to anything like 3 to 4 per cent. even. It is reported from Bihar and Orissa, Assam and other provinces that the mudatti hundi has almost disappeared from use while in the province of Bombay, the cities of Bombay and Shikarpur which are the native places of the indigenous bankers dealing in bills, alone retain it in their affections. Bengal is perhaps the only important province in which the mudatti hundi is still in common use. Everywhere else the darshani hundi or demand draft which is on a par with promissory notes in regard to stamp duties and pays only ¼ per cent. has taken its place. With the quick means of transport, the darshani hundi is obviously of little use for the grant of short term credit.

In the second place, the free negotiability of a hundi is apt to be much restricted by certain conditions which are attached to it by usage. As a conditional document, it does not then fall within the definition of a bill of exchange in the Negotiable Instruments Act. Three classes of hundis may be distinguished in this connection. The sah-jog or shah-jog hundi is so-called because it is payable only to a shah i.e. payable only after ascertaining the respectability, title and address of the payee. Although, as in Bombay, the shah condition may be increasingly ignored in practice, its presence cannot but limit its legal capacity to circulate. The shah jog hundi is in most common use in Bombay, Bengal, Central Provinces, Bihar and Orissa, etc. The second class of this indigenous instrument of finance consists of jokhmi hundis which are to be sometimes met with in Bengal but are not found at all in certain other provinces like Bihar and Orissa. In the jokhmi hundi, the drawer or the holder of the hundi and not the drawee is required to bear loss in case of destruction or damage to the goods which gave rise to the paper. Finally we have got in this country the Dhani-jog hundi which corresponds to the true bill of exchange. The dhani *i.e.* the party to whom the hundi is payable means in this case

the holder. With the exception of Assam where it is usually known as hundi-jog and is in very common use, no other province reports more than a very infrequent appearance of this instrument.

Local variations from these well-established and well-known forms, tending either to retard or facilitate their circulation, are to be noted here and there. The shroffs of Bombay have attempted to overcome the disadvantages of conditional hundis by introducing a class of bearer instruments described as dekhadnar-jog hundis *i.e.* hundis payable to him who presents. Its circulation is however limited to Bombay and Gujarat where the Gujarathi shroffs are present in large numbers. Firman-jog hundis *i.e.* instruments payable to firman or order were also tried but have failed to establish themselves. Far in the South, the great banking caste of Nattukkottai Chettiyars use a sight bill called nadappu vaddi hundis. These are so called because they are discountable at the nadappu rate—the rate fixed by Nagarathas on the 16th of each Tamil month at Madras and Rangoon. This variable rate is itself a difficulty when banks are approached to discount them.

In the third place, there is nothing on the face of a hundi to indicate whether it is a trade bill arising out of a genuine deal in goods or mere accommodation or finance paper. No documents of any kind, whether railway receipts, warehouse receipts, etc., are attached. In Bengal and the United Provinces, hundis serve almost always as a means to borrow. In Bihar and Orissa, as much as 37 per cent. of the remittance business was found in the thirties to be executed by means of hundis. The Nattukkottai Chettiyars in Madras use this paper very largely for purposes of accommodation and remittance in their widely spread business in Burma, Ceylon, Strait Settlements, etc. An advance on a hundi is thus generally an advance on the personal credit of the parties.

In spite of these difficulties, the high specialisation achieved in this business by a few castes and communities has made the hundi the prime and most ancient instrument

of finance in this country. The Marwaris are almost in entire possession of the field in Bengal and Assam while in Bihar and Orissa they share the trade with Gujaratis and Kachis. In Bombay, Gujarati, Marwari and Multani or Shikarpuri shroffs share the honours equally and are organised in their respective associations.* In Madras, the Nattukkottai Chettiyars who are estimated to employ as much as Rs. 50 crores of their own capital in the banking business have to face competition from Marwaris and to a much less extent, Multanis and Kullidiakurchi Brahmans of Tinnevelly. In many places, as in the United Provinces and Bihar and Orissa, some of these people act as brokers pure and simple in the capacity of dalals or sarefs.

The strong ties of caste and community tend on the other hand to isolate the hundi market from the general modern market for short term funds. The Nattukkottai Chettiyars raise some thavanai or fixed deposits for periods of 2 to 3 months and, at their nadappu rates, some current deposits as well. Rates offered by them are as a rule higher than those of joint-stock banks. Multanis accept little deposits. When in need, they apply to their native place, Shikarpur. The Marwaris are even less inclined to approach the outside market for deposits. In the province of Bombay, except for the capital city and the bigger cities, the busy season is met very largely by inter--shroff borrowing which significantly enough is cheaper than borrowing from banks.

As for the practice of discounting, in most places in the country the payee, when a merchant, rarely discounts. The indigenous bankers resort to banks more frequently. In Bombay and the bigger places in the province, shroffs replenish themselves at their banks by means of either promissory notes of two approved shroffs or by re-discount of hundis. In a place like Cawnpore, discounting and re-discounting in the native bill market are more common.

* During the season of 1937, multani shroffs in Bombay were estimated to have loaned well over 11 crores in the bazar.

The extension of bank branches, restricted urgency of loans to the bill market, lack of standardization,* etc., are several other factors which limit the future growth of a market in domestic bills. For similar reasons, creation of large quantities of foreign trade bills also appears to have only a limited future. Vast distances, natural obstacles to full and accurate information, etc., make the intervention of a bill and discount market even more advantageous in this field. But in the absence of a large maritime trade, a world-wide network of financial and economic service, such as England has, the basis for foreign bills must be relatively slender. As our more exhaustive analysis of this subject in another section will show, the sterling-bill and operators in sterling bills, namely, the exchange banks, control the whole field of foreign trade finance.

Just at present, the volume of bill-discounts is very insignificant in India. In 1928, the five leading Indian joint-stock banks held bills of domestic origin to the extent of 7·1 per cent. of their aggregate deposits. For Indian Scheduled Banks which include the Imperial Bank and exclude exchange banks with their high specialization in foreign trade bills, the percentages for the three years 1935-37 were 3·2, 5.·0 and 5·9 respectively.

The volume of bills discounted fluctuates much according to the course of prices and trade. The figures compiled for the Big Five or Big Seven of Indian joint stock banks demonstrate this very clearly. Before and during the early part of the Great War, the proportion of bills discounted to their deposits was 15 per cent. and even more. In the later stages of the War, dislocation of foreign trade, exchange rectrictions, etc., caused a steep shrinkage in foreign trade bills and consequently in that portion of

* Standardization is required in respect of the following points :—

(i) Although Hindi with different scripts is used as a rule, a Hvndi printed in vernacular and English seems very desirable.
(ii) Time and hours of presentation, acceptance etc. Business till midnight is not uncommon.
(iii) Days of Grace.
(iv) Holidays. In C. P. entering of office dhara means that holidays are excluded.
(v) Procedure in case of lost hundis.
(vi) Procedure in case of dishonoured hundis.

our domestic bills which are meant to finance the movements of our goods from the interior to the ports. The tendency to shrinkage continued steadily even after the war and by 1929, their proportion had fallen from about 10 per cent. in 1919-20 to about 6 per cent. The collapse of prices and trade in 1929-30 caused an immediate contraction to about 3 per cent. and after still further deterioration, the proportion recovered to 3½ per cent. only by 1937.

The Imperial Bank which participates on a larger scale in short-term seasonal accommodation shows parallel movements although on a higher plane. As high as 20 per cent. in 1914, the proportion stood at about 12-13 per cent. during the war. It fluctuated much in the next few years but reached higher levels just before the crisis. The crisis affected the Bank most, the proportion was only 2·4 in 1933, recovering thereafter to more than 6 and 7 per cent. by 1937-38.

Indeed it is a matter for speculation whether this asset, so well beloved of bankers, will ever again assert its old quantitative importance. Forces of a more permanent character than the course of trade and prices are active in retarding the recovery of bills to their old levels. In many countries, notably in the United States, industry now prefers to finance itself by direct appeals to the capital market instead of bills floated against its assets in general. Movements are on foot in many countries to eliminate the wholesale merchant and as many intermediate stages between producer and consumer as possible. The seller instead of drawing a bill on the buyer is inclined to throw the burden of arranging the finance on him and the buyer prefers to create an overdraft at his bank which enables him to extinguish the debt by instalments and thus save in interest charges. The more frequent use of telegraphic transfers tends in the same direction, *i.e.*, narrowing the basis for creation of bills. It is true that some of these forces have not yet become visible in this country and others are operating but weakly. Sooner or later, however, changes occurring in

the finance of foreign trade are sure to affect the volume of domestic bills also, the two operations of financing trade between the interior and ports and between ports and foreign countries being indissolubly linked.*

Although ordinary commercial bills as outlet for short-term investment seem destined not to recover their pre-war importance, another kind of bill has greatly grown in volume in post-war years. These are treasury bills which are now issued both by central and provincial governments and in which the Reserve Bank, ordinary banks, governments, commercial bodies, etc., find an excellent lodgement for their temporary surpluses. But while treasury bills offer all the advantages of liquidity, specific maturity, etc., they do not require any grading or further endorsement to enhance their security. The banks can therefore tender for them directly. In other words, no elaborate machinery of a bill and discount market is necessary in their case. The importance of treasury bills as a factor in the money market may be inferred from the fact that the total of treasury bills outstanding with the public, the Reserve Bank and Provincial Governments and Burma stood at Rs. 31, 28·54, 38·01 and 46.30 crores at the end of the official years 1935-36 to 1938-39. These figures might be compared with the year end holdings of ordinary bills of the Imperial Bank and four of the Big Five (the Punjab National Bank being excluded) which were Rs. 6·4, 8·4 and 7·6 crores for the years 1936 to 1938. Even if these holdings reached their pre-crisis proportion to deposits, the volume must still be comparatively small. The importance of the treasury bill as a factor in the money market has been recognised by the Reserve Bank which has intimated to the scheduled banks its willingness to purchase from them Central Government treasury bills

* Bills. (Percentage to Deposits.)

	1914	1915	1920	1928	1929	1931	1935	1936	1937	1938
United States ...	...	...	...	...	...	...	...	...	...	...
England (Clearing Banks)	...	...	...	...	13.2	...	14.6	15.5	18.0	...
France (4 deposit Banks)	...	...	...	...	...	...	58.0	61.0	...	...
Germany (5 Germany Banks) ...	...	...	...	...	...	...	45.6	55.7	...	... ...
Indian Scheduled Banks	...	...	...	...	...	...	8.2	5.0	5.9	
Big Five (Indian Joint-Stock) ...	14.7	14.7	10.1	7.1	6.6	3.0	2.0	2.9	3.6	...
All Scheduled Banks	...	...	...	...	...	...	2.8	2.4	1.5	...

of currency up to three months at fine rates on the current tender rates. The banks have naturally been encouraged to invest in treasury bills and to make use of this facility at the Reserve Bank.

We have examined the nature of call loans and the rates charged on them in our chapter on Structure of Interest-rates.* The other important use of short-term loans to the money market relates to dealings on stock exchanges. The nature and effect of loans for this purpose as also inter-bank loans are analysed elsewhere.†

Investments

Banks invest a proportion of their resources in government and non-government securities partly as a source of steady income and partly as a means to raise cash when required. From the latter standpoint government securities are preferred as being less liable to depreciation. Even among government securities, short-dated ones obviously give better protection from fluctuations in value. Under banking conditions such as obtain in India where scheduled banks have to depend more on loans against securities than on discounts at the central bank, the definition of securities eligible as collateral for loans must exercise a powerful influence on the choice of investments by banks.‡

The relative importance of investments differs from one banking system to another according to the availability of alternative outlets for funds and relative position of short and long rates. Investments of British clearing banks which have access to the largest money market of the world have rarely reached 30 per cent. of deposits and are usually well below 25 per cent. The presence of special institutions for long-term finance in France and ample scope for short term investments as discounts or

* Pp. 66.

† See pp. 264; 392-94.

‡ Pp. 272-74.

loans to the stock exchanges in France and Holland reduce investments almost to insignificance in these countries. The heterogenous and scattered banking structure of the United States and its great dependence on local business and interests appear to make investments a great necessity there. In India, limited scope for investments in bills or loans to the money market is an important factor in making the more liquid and realisable securities eagerly sought by banks.

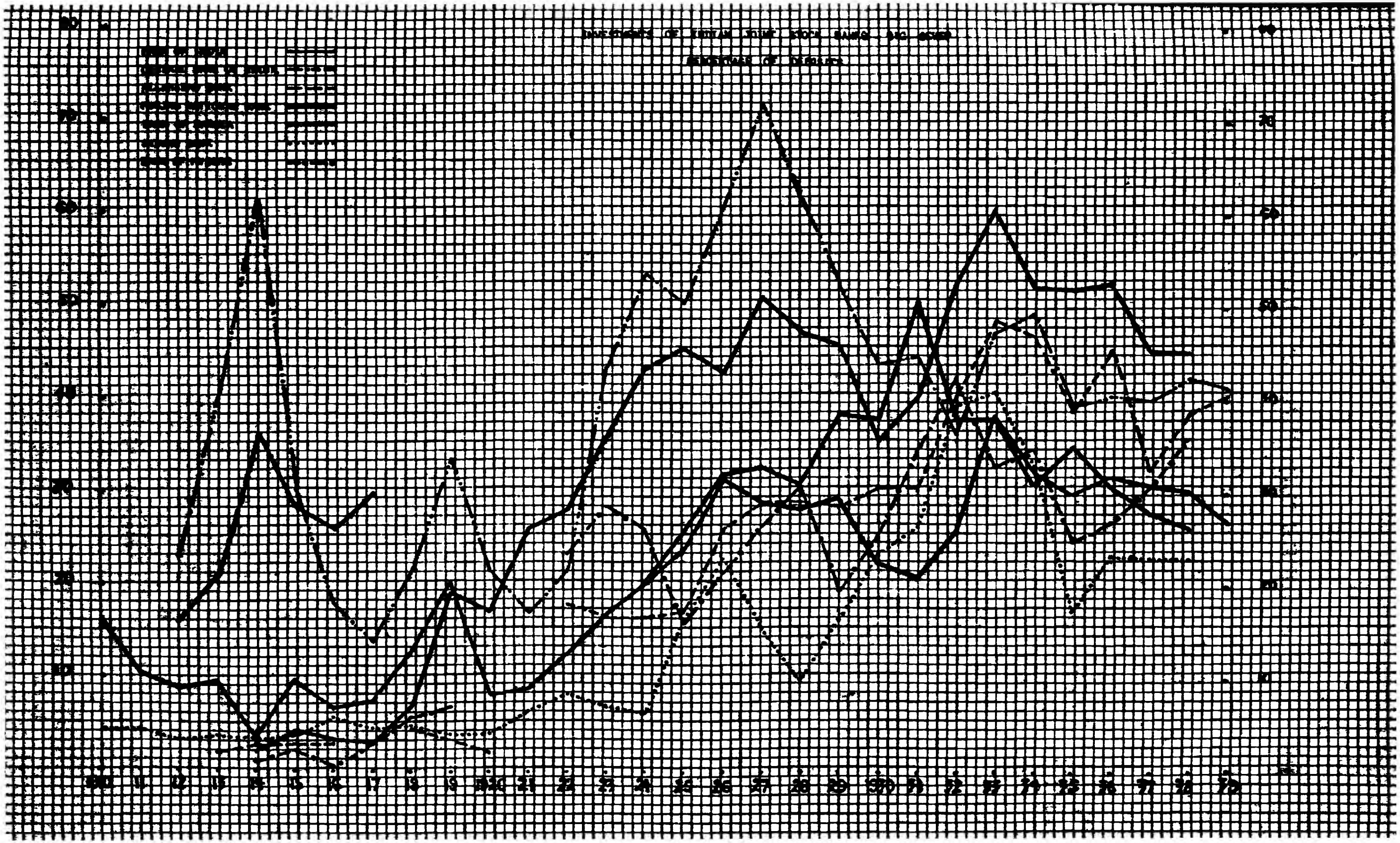
The relative position of short and long rates and more particularly, cyclical trends in rates and security values cause marked cyclical and secular changes in investments. When the long rate was expected to rise and securities to depreciate in the early years of the Great War, investments of the Big Five sank below 8 per cent.* Widening differentials between short and long rates and enormous pressure for short-term accommodation made investments even less attractive. The burden of maintaining the values of government securities fell on the Imperial Bank which continued to maintain its securities at a high level of 20 per cent. Investments of the Big Five began to mount slowly in the later stages of the War when the differential began to narrow and government issued its vast terminable loans. As the long-term rate fell steadily from 6·2 per cent. in 1921 to 4·4 in 1927, both the Big Five and the Imperial Bank hastened to profit from these appreciating investments. By 1928, the Imperial Bank reached a percentage of 27·4 but the Big Five recorded the much higher level of 45 per cent. When the approach of the crisis initiated a stiffening of rates which continued till 1932, there was some hesitation and even a desire to reduce the volume. The proportion of government securities shows a tendency to decline. But the abandonment of the gold standard in England and the linking of the

* From Rs. 92, the price of 3½ p. c. security fell to 68 in 1917.
" Rs. 70, " " " 59 in 1920.

rupee to sterling brought about a dramatic change; the long rate fell steeply from 5·7 in 1932 to 3·5 in 1936 and short rates collapsed much more. The Big Five staged a recovery but they had already moved into securities in the period of falling long rate between 1921-28 to such an extent that despite a further collapse in loans, advances and bills, the scope for further loading of securities was limited. As pointed out in another section,* they were now inclined to develop certain other lines of investment. The position of the Imperial Bank was different. It had not suffered in the pre-crisis years so much as other banks in its short-term business and it had not loaded itself with securities to their extent. But now, deprived of its mainstay of short-term accommodation to which its charter confined it, the Imperial Bank added to its securities quickly till it reached 66 per cent. by 1936. In a single year, 1929-30, the proportion increased by 14 and in another turning-point year 1932-33 it made another stride by 15.

Naturally, Indian joint-stock banks differ among themselves in the extent to which, in order to meet these vicissitudes, they have rung the changes on their investments. The Bank of India and the Bank of Baroda which pursue a stricter policy of short-term finance have contented themselves with a moderate and steady volume of investments. The Central Bank of India and the Allahabad Bank have made more frequent and larger changes in this class of assets, the former largely as an alternative to cash. The Indian Bank does not find investment more attractive than the re-lending business it has developed through the medium of the Chetties, the premier money-lenders and indigenous bankers of the South. The Punjab National Bank does not find its assets sufficiently elastic to permit much cyclical or secular adaptation of investment. Since 1936, incalculable factors of war and politics began to exert themselves on the

* See pp. 147-65


INVESTMENTS OF INDIAN JOINT STOCK BANKS
PERCENTAGE OF DEPOSITS

banking situation and a general though somewhat hesitant tendency to reduce investments has made itself visible.*

Our previous analysis does not support the general belief that Indian banks invest a disproportionate part of their resources in government securities. On the contrary, their investments show a commendable degree of elasticity and adaptability according to circumstances. The present high level of government securities is not peculiar to the Indian banking system as such. It has been a widely observed feature of banking in many parts of the world. With the present relative position of short and long rates, no other policy could commend itself to banks.† It may be that elasticity and adaptability of investment policies in India relates to a larger volume on the whole than is found in other countries. But it must be borne in mind that these countries have as a rule a second line of protection after cash in their call-loans to the bill markets or the stock exchanges.

It is not easy to make out how far the present low level of loans and advances reflects cyclical conditions which are bound to pass away and how far it is a part of a secular tendency to contraction and represents a fundamental change in the methods of finance. The falling volume of loans, advances and discounts suggests that the

* Investments.
(Percentage to Deposits.)

	1913	1914	1915	1930	1925	1928	1929	1931	1935	1936	1937
United States ...	...	...	...	...	...	...	34.9	41.0	67.9	69.	61.3
England ...	...	...	27.0	16.7	15.3	...	14.3	...	30.2	27.	27.2
France (including Premises) ...	...	...	...	...	...	...	...	...	1.3	1.2	...
Germany ...	...	...	...	...	...	...	...	...	8.9	17.	...
Indian Scheduled Bank ...	...	...	...	...	...	...	...	...	51.5	55.	50.3
All Scheduled Banks ...	...	...	...	...	...	...	...	...	42.0	48.	49.4
Big Five (Indian Joint-Stock) ...	7.8	8.8	8.4	12.0	88.6	45.3	38.8	35.6	36.9	40.	37.2
Imperial Bank ...	...	19.7	28.7	...	20.3	27.4	41.5	40.4	59.1	66.	58.6
Bank of India ...	9.9	3.5	9.5	8.6	42.0	28.2	29.3	22.2	29.8	31	31.1
Central Bank ...	40.0	61.3	30.2	21.4	53.3	61.7	52.9	44.7	39.5	40	40.1
Punjab National Bank ...	21.4	36.2	28.4	...	26.0	30.8	33.3	50.6	35.1	31	28.1
Bank of Baroda ...	...	2.3	4.2	17.1	45.5	47.3	45.9	40.4	52.0	51	45.8
Allahabad Bank...	2.0	3.0	2.9	1.8	17.2	29.2	28.7	30.8	35.1	32.	32.6
Indian Bank ...	3.7	4.7	...	...	16.1	10.1	16.6	26.7	17.7	28	28.2

† 1936 Government Securities.
(Percentage of Total Assets.)

Canada	...	39.6
United States	...	38.1
South Africa	...	26.2
United Kingdom	...	28.8
Belgium	...	16.3

P. 85. League of Nations, Monetary Review, Volume II.

subsequent collapse is merely an aggravation of a deep-rooted trend. The banking system is therefore confronted with a more permanent problem viz., how to replace these time-honoured assets with some others worthy of its traditional place in the banking system. For the present, the void has been filled very largely with government securities. Unless banks are content to become investment trusts, however, a rise in the short rates and long rates will cause a disgorging of securities and revive the problem of alternative outlets. Even at present, the pressure of surplus funds and limited outlets has been by no means insignificant.

One or two of the Big Five, have always held a small proportion of their funds in Improvement Trust, Port Trust, and Municipal Bonds. Only two among them make a separate return. Their proportion was 4 per cent. in 1926 but has risen well above it recently. A much more significant development has been the changed attitude towards industry. Four of the Big Five have increased their proportion of funds invested in debentures, shares and stocks of joint stock companies. Two per cent. only of deposits in 1924, the level stood in 1938 at about 5½ per cent. The implications of this tendency are examined in the following section of this chapter.

Cash

Banks seek safety partly in highly shiftable assets like loans to the bill and money markets or in actual cash. The cash ratio of Indian banks as a whole is generally much higher than in the United States or in England. British Banks adhere to a ratio of approximately 10 per cent. from which only moderate departures take place from time to time. The cash-ratio tends to average to the same level in the United States but fluctuations round the average are apt to be much wider. Between 1929-37, the United States ratio has moved between a substantial margin of 8·6 per cent. to 16·7 per cent. The relatively low cash-ratio of British clearing banks is easily explained by the important place which call and short loans occupy

in the assets. The lower cash-ratios of the United States are perhaps justified by the large volume of call-loans offered by banks to the stock exchange. Perhaps, the country which is most similar to India in this respect is France where about 20 per cent. is the normal ratio. The need for such a high proportion is explained largely by the extent to which coins and notes are used in ordinary transactions. But there also exist important differences between France and India which deserve careful notice. Banking in India is concentrated in a few large urban and industrial centres where the cheque habit is much more developed than elsewhere. In France, banking facilities have been carried to the remotest villages which makes need of cash much more urgent. The situation is partly remedied by the fact that, in France, the scope for loans and advances is very limited while the habit of creating bills for even small transactions furnishes banks with a liquid asset which they can always use at the Bank of France or otherwise to replenish their cash.

Among Indian banks themselves, cash-ratios show quite remarkable disparities. These disparities are partly due to policy and partly to the extent and character of the regions they serve. Banks which like the Bank of India confine their operations to a few large urban and industrial centres are always able to show a relatively more liquid position. Other banks like the Imperial Bank, the Central Bank of India, Bank of Allahabad, etc., which either belong to or have spread into the smaller places and the countryside, show large variations in their cash-ratios. Some of them adhere strictly to short-term finance while others venture into mortgage or long-term business. The persistently low cash-ratios of the Punjab National Bank even in times of stagnation after 1930 indicates a large participation in long-term business. The Imperial Bank which by its charter or inherited practice is confined to short-term business shows high but fluctuating ratios. Other banks lie between these extremes inclined largely

to short-term business but participating to a fair extent in long-term business as well.*

Fixed Assets †

Fixed assets consist of immovable properties like bank-premises etc. and the equipment of the offices. Obviously, they are incidental acquisitions and not an integral part of the business of banks as such. But several factors are apt to invest these assets with more importance than their intrinsic affinity to banking could justify. Many times, these assets fall into the possession of banks unsought because they formed the security of loans which have not been repaid. In the second place, it is a practice with many banks to undervalue them as a device for creating hidden reserves. On the other hand, many banks find in their valuation a means to conceal losses or bad debts. For these reasons this item in the balance-sheets deserves closer scrutiny than it would otherwise attract.

* **Cash.**
(Percentage to Deposits.)

	1914	1915	1920	1928	1929	1931	1935	1936	1937	1938
United States ...	...	...	...	...	8.6	9.5	15.8	13.4	10.9	...
U. K. (Clearing Banks)...	...	...	...	...	10.8	...	10.5	10.0	10.2	...
France (4 Deposit Banks)	...	...	...	...	...	...	20.0	19.6	...	...
Germany (5 Banks) ...	...	...	...	...	...	...	3.5	...	2.5	...
Indian Scheduled Banks	...	...	...	...	...	...	13.5	12.9	12.9	...
All Scheduled Banks ...	...	...	...	...	...	...	17.3	14.0	12.8	...
Big-Five ...	27.3	21.5	21.2	13.9	13.4	12.1	10.9	15.9	16.5	...
Imperial Bank ...	46	...	30	...	18	15	24.5 (0.2)	9.9¶ (0.9)	13.3¶ (3.1)	6.9¶ (9.1)
Exchange Banks A ...	28	...	30	...	15	15	...	...	...	...
„ „ B ...	26	...	58	...	10	9	...	...	...	...
Indian Joint-Stock Banks—A ...	21	...	28	...	14	13	...	...	...	...
Indian Joint-Stock Banks—B ...	22	...	18	...	13	12	...	...	...	...

¶ Ex. balances with other banks.

† **Fixed Assets.**
(Percentage of Capital, Reserve and Deposits)

	1916	1917	1927	1929	1930	1934	1935	1936
Bank of India	0.07	...	0.9	0.9	...	0.5	...	0.5
Central Bank of India ...	...	...	5.1	6.2	6.2	...	4.9	4.4
Punjab National Bank ...	...	...	4.1	...	10.1	14.8	14.5	13.3
Bank of Baroda	...	...	2.6	2.8	2.7	3.2	3.4	3.0
Bank of Allahabad ...	3.2	3.3	...	...	3.9	4.5	...	4.2
Indian Bank	...	...	...	...	0.06	...	...	...
Imperial Bank	...	...	2.9	...	2.9	2.6	2.5	2.4

The disparities in the ratios of fixed assets are indeed remarkable. The Central Bank which acquired the imposing premises of the Tata Industrial Bank shows a substantial ratio. But banks like the Bank of India which depend on hired premises very largely naturally show much less significant ratios. More remarkable and suggestive than these disparities is the tendency of some banks like the Punjab National Bank to show an increasing ratio from year to year.

Other Services of Banks in India

Besides the collection of temporary savings and their investment, banks in India engage in many other services some of which are cognate to banking while others are essentially non-banking in character. The years after the Great War witnessed a remarkable expansion of such non-banking activities in most countries. The impelling motive is the substitution of impersonal and therefore disinterested agency of banks in the place of individuals like solicitors and brokers who offer no doubt the advantage of greater adaptability and informality but cannot be expected to be always above self-interest. As the custodian of all financial interest, the banker indeed bids fair to take his place alongside the trinity of the family doctor, priest and lawyer.*

As elsewhere, banks in India undertake transfer of funds by telegraphic transfer or demand draft as required. Each bank makes a minimum charge for the purpose—about 4 annas per cent. while, for larger amounts, favourable rates are quoted. The scheduled banks make use without charge of the agency of the Reserve Bank which in its turn makes use of the Imperial Bank and its numerous branches and pay-offices.

Many banks receive valuable articles whether ornaments, securities, etc., for safe custody and have built modern vaults

* The bank-Manager in the moffusil is recognised even in India as an important member of local society and his activities are apt to extend much beyond his official narrow sphere. It appears to have been quite an ordinary occurrence early in the present century to be called in to draw up wills and to settle petty matrimonial squabbles. Indian banks have yet to recognise the value of social contacts outside formal banking relations on the part of their managers particularly in the moffusil.

Commerce. May 27th 1938.

for the purpose.* The usefulness of such services in a country like India where people hold such a large part of their savings in precious metals and stones hardly needs any emphasis.

Many banks undertake to buy and sell shares, stocks, etc., on account of their customers. Advice on investment is a natural incident of such activities and banks employ suitable staff for this purpose. It cannot be said that banks have yet made any systematic efforts to build up this business to the full possible extent. As pointed out elsewhere,† there is every advantage in banks replacing the individual broker in as large a part of this business as possible. In order to facilitate this development, the rules of our stock exchanges should be amended so as to permit at least scheduled banks to become members of these institutions. Many of our brokers could then find employment as salaried officers of banks and be freed from the temptation of offering any advice but what should conduce to the welfare of the clientele. New flotations would not then find their course as easy as at present since a bank's support, although very decisive, will be obtainable only when the bank has carefully scrutinised the position and satisfied itself on all relevant points. The customer also will not have to pay a double commission as at present on the ground that the bank has to put through its business through a regular broker.

Some of the more respectable banks have also ventured into executor and trustee work. The execution of wills is made a very difficult task in India by the complicated personal laws of each community and the proneness of

* Early in the present century, the "strong room" of a bank in Quetta which accepted regimental plate for safe custody was a mere lean to bath room! At Peshawar, a bank had an armed guard at night which was composed of a dozen wild Pathans armed with ancient muzzleloaders and without any ammunition. No ammunition was known to have been supplied either within living memory! People, however, seem to have been more honest than now. It is recorded how in Simla, a peon about 18 years old could go to the Bank of Bengal with a cheque of Rs. 50,000, collect 50 miscellaneous coolies from the local bazar, place a bag containing Rs. 1,000 on each head and then lead the procession to the payee bank without any guard and without any mishap.

Commerce. May 27th 1968.

† Chapter XI

parties to evade wills in their own interests by collusion. More lamentable is the state of administration of trusts in favour of widows, minors and charitable objects. The agency of banks for these purposes has an advantage which no other private agency can offer. Unfortunately, the work involves great costs and when banker's costs are added to ordinary legal costs, the facility is hardly worthwhile for any but big estates. Larger social ends may more than justify a lightening of legal charges when execution of wills and administration of trusts are sought to be put through the medium of banks. The banks on their part have also yet to make efforts to organise their work on a basis more suitable to the means and circumstances of this country.

Smaller Banks

The foregoing analysis of the structure of assets and liabilities of banks is based on the balance sheets of the biggest seven or eight among Indian joint-stock banks and, for the last three or four years, the consolidated balance sheets of all scheduled banks. Of the aggregate resources of banks which have paid-up capital and reserves of Rs. 1 lakh and more, the scheduled banks account for about 90 to 95 per cent.

Still, by their number and territorial jurisdiction, if not by their resources, the other twenty-five smaller scheduled banks and the non-scheduled Class B banks equal in importance the big scheduled banks. We have noted that they are responsible for banking facilities in as many more places as are covered by the bigger banks and that they claim as many, if not more, bank offices and branches.* In addition to these banks, we have also to bear in mind the 525 and odd banks which have a paid-up capital and reserve of less than Rs. 1 lakh.†

* Chapter III, pp. 19; 24; 26; 33.

† Pp. 34-35.

The following table summarises the broad facts concerning all non-scheduled banks.

December 1938 (figures in lakhs.)*

	Non-scheduled banks	Non-scheduled Banks with capital and reserve between 1 and 5 lakhs† 1935	1936	Non-scheduled Banks with capital and reserve between 50 thousand and Rs. 5 lakhs	Non-scheduled Banks with capital and Reserve below 50,000
Number	1,421	74	74	236	1,185
Number submitting cash reserves	672	74	74	195	477
Number of balance-sheets analysed ...	418	74	74	153	265
Total capital and reserves	254	150	156	213	41
Capital and reserve per bank (000s) ...	61	......	200	140	15
Capital and reserve per cent. of deposits ...	21.3	27.5	28.2	20.9	23.1
Total Deposits ...	1,197	544	552	1,025	172
Deposits per bank (000s)..	286	......	800	670	65
Cash	156	84	102	135	21
Cash per cent. of deposits	13.1	15.4	18.4	13.1	12.3
Investments	230	......	63 (Govt. and gilt-edged)	212	18
Investments per cent. of Deposits	19.2	......	11.4	20.6	10.8
Loans including bills ...	1,025	482	485	858	167
Loans per cent of deposits	85.6	88.6	87.8	83.7	96.9
Branches per bank ...	1.7	......	......	2.2	1.4

Deposit-Structure of Non-scheduled banks. (lakhs)
December 1938.

	Number	Deposits. Total	Deposits. Average	Time-Deposits. Total	Time-Deposits. Percent of deposits	Demand-Deposits Total	Demand-Deposits Percent of deposits
Banks with capital and reserve of less than Rs. 50,000	1,185	457	1.03	324	71.1	132	28.9
Banks with Capital and reserves of Rs. 50,000 and more	236	1,085	5.84	834	76.9	251	23.1

Capital-Structure of Non-scheduled Banks.
December 1937.

Paid-up Capital and Reserves.	Banks with capital and reserves of less than Rs. 1 lakh.	Banks with capital and reserves of less than 5 lakhs and more than 1 lakh	
Below 5 thousand	377	1 Lakh to 2 lakhs	65
5 to 10 thousand	236	2 lakhs to 3 lakhs	17
10 to 20 thousand	237	3 lakhs to 4 lakhs	10
20 to 30 thousand	126	4 lakhs to 5 lakhs	9
30 to 40 thousand	58		
40 to 50 thousand	50		
50 thousand to 1 lakh	135		
Below 50 thousand but unclassified	101		
Total	1,320		101

* Appendix B. Proposals for An Indian Bank Act (Reserve Bank of India Publication).

† Statistical Abstract relating to Banks. 1938.

The proportion of capital and reserves of Class B banks to their deposits has always been strikingly high. In recent years, it has continued to be as high as 27 to 28 per cent. It is obvious that this merely indicates their incapacity to attract deposits on the scale of other bigger banks. It will be recalled that their growth has been generally growth in numbers and not in average size.* In 1936, their capital and reserves averaged to about 2 lakhs per bank and their deposits to a little more than 7 lakhs.

With borrowed resources limited in this manner, their employment of funds has to seek avenues which yield generous profits rather than conform to accepted standards of liquidity, etc. As much as 88 per cent. of their deposits is returned as invested in bills and loans which are as a rule the most lucrative assets in the balance sheets of banks. That such a high proportion should hold true of years of such exceptionally low interest-rates as the present suggests that either the loans are of the more lucrative and therefore risky kind or they are frozen to a great extent. Investments in government or gilt-edged securities are barely 12 per cent. of deposits and in some individual cases they are almost non-existent. The only bright spot in the picture is the relatively high ratio of cash-balances.

Most of the observations suggested by facts relating to Class B banks hold good on an aggrevated scale for the 500 to 600 other banks which have a paid-up capital of less than Rs. 1 lakh. Many of them are really more money-lending institutions than banks. It is probable that the average capital and reserves of those banks which have capital and reserves between Rs. 50,000 to 1 lakh is nearer 60 thousand than any higher figure and their deposits average to about 2 lakhs. In the case of banks whose capital and reserves fall short of Rs. 50,000, the average capital and reserve per bank is only about 15 thousand rupees and the average deposits about 65 thousand. These latter banks number 477 as against 94 only of those whose capital and reserve fall between Rs. 50,000 and Rs. 1 lakh.

* P. 19.

As long-term loans form an appreciable part of their business, they depend very largely on their own funds. Time liabilities predominate in an overwhelming manner in whatever deposits they are able to attract. The proportion of current deposits seems to range much nearer one-quarter than one-third of the whole. It is usual for small banks in the smaller towns to have their deposit-liabilities composed almost entirely of fixed deposits.

Their social and economic basis pre-determines the character and principles of their business. Many of them avowedly exist to serve the interests of particular castes and communities or particular classes of persons like government servants etc. It is a necessary consequence of this as of their small capital and reserves that most of them are unit banks. The bigger ones among them, those with capital between Rs. 50,000 and 1 lakh for example, may have a few branches but their essential limitation to and pre-occupation with local interests and local opinion mean inability to extend or adventure much beyond the outskirts of their home town or home province.

Since many of them exist to meet the needs certain narrow communities and areas, it is inevitable that the personal element should predominate in everything. The bulk of funds as in the case of Class B banks flows into loans and advances. The needs of directors and their friends rather than impartial assessment of the merits of applicants, personal credit and paper security rather than tangible security these and other factors undermine the quality of assets held. Gilt-edged investments are either insignificant or in many cases do not exist at all. As Section 277 L of the Indian Company Law prescribes for every non-scheduled banking company a minimum cash balance equivalent to at least 1/2 per cent. of time-liabilities and 5 per cent. of demand liabilities, the natural tendency of these banks is to hold as low cash as possible under the Act. In the light of these circumstances, it should not be surprising if most of these banks are found in a chronic state of frozen assets.

We have recorded already what a large part in the credit facilities of this country is borne by the loan-offices of Bengal and Nidhis and Chits of South India. While it is probable that the ancestry of these institutions could be traced to very early times, their modern history dates largely from post-Mutiny days. We may well conclude our present study with a brief description of the business and character of this undergrowth of our credit structure.

Loan-Offices of Bengal

The loan offices of Bengal are among the many offshoots of the permanent settlement which made land more valuable there than elsewhere. Although the paucity or abundance of local money-lenders is a factor in their growth, the main influence determining their number and distribution is the productivity of land and ensuing demand for loans. Zemindars and superior classes of holders of land compose the chief clientele of these loan-offices.

Their number at any time depends on the phase of the agricultural cycle and is maintained very largely by new births which more than counterbalance their continuous mortality. Of 782 loan offices which were in existence in March 1929, as many as 400 were launched after 1925-26. Their present number most probably exceeds 1000.*

Their paid-up capital is generally small. In 1929, there were only five whose capital exceeded and only three whose capital was equal to, Rs. 1 lakh. As they attract deposits, the working fund is perhaps a better index to their financial status and utility. Of 381 loan offices in 1929 for which statistics were available, the working fund of 15 exceeded Rs. 10 lakhs and in the case of as many as 199, it fell below Rs. 50,000. The total working fund of all loan offices was more than Rs. 9 crores.

The longest period for which deposits are accepted rarely exceeds 5 years. The bulk of deposits is composed of short deposits which are payable at 1 month's notice and intermediate deposits which are repayable within 2 years. The

* Pp 34-35.

rates offered vary between 4 to 8 per cent. as a rule. Unfortunately, competition for deposits is sometimes very keen and touting and offer of absurdly high interest rates are a growing practice.

Their description of business in their memoranda of association is apt to be in the widest possible terms and ranges from bus traffic pure and simple to transport by all mechanically constructed carriers "in land, water or air." Actually, the vast majority is chiefly interested in mortgage loans against land and ornaments. The newer ones are developing loans against personal credit. There is a tendency also to give up the older practices of trading, Zemindari, etc., and the bigger ones like Comilla, Luxmi, etc., are increasing their proportion of liquid and purely banking business. The rates charged are apt to range in most cases between 12 to 18 per cent.

The fact that the management is usually vested in practising lawyers throws a great deal of light on their nature and business. On the one hand, the stimulus to the growth of loan offices is perhaps supplied by educated unemployment while, on the other, the knowledge of lawyers regarding the legal and financial affairs of their clients is the essential basis of their business.

Nidhis and Chits of South India

The Nidhis of South India are distinguishable from other credit institutions registered under the Company Law by three main features. Their share capital is paid by monthly instalments spread over a certain predetermined period. The paid-up capital is withdrawable at the end of the period when the Nidhi automatically ceases to exist. Finally, the members of the Nidhi are entitled to borrow against their share capital, which is tantamount to a reduction of capital and therefore the security of the creditors and is clearly contrary to the law and principle of joint-stock companies. Some of the Nidhis are now coming into line with the Company Law on all these three major points; out of 114 examined in 1929, eleven were reported to have adopted the practice of other joint-stock companies.

They attract deposits. 218 out of a total of 228 in 1929 showed a paid-up capital of 244 lakhs, deposits of 116 lakhs and small reserves aggregating to only 31 lakhs. Many of them have fixed margins for their loans—90 per cent. against share-capital, 90 per cent. against deposits, 50 per cent. against jewels, 80 to 90 per cent. against gold and silver, 75 per cent. against goods in godowns and 90 per cent. against government paper. That their main object was to meet the credit needs of the humbler folk is proved by the fact that the orthodox type has the same borrowing and lending rates. The source of profit is the fines and penalty interest levied on defaults and delays, and constitutes usually the perquisite or remuneration of the promoter and manager.

With Chits, Chit Funds or Kuries of South India, we move furtherest away from modern credit institutions as such. The promoter who is more often than not a needy man of straw invites members to make periodic payments to him over a period of time which is predetermined. Out of the payments received from members on each occasion, an advance is available to a member in either of two main ways. In the auction Chit, the promoter himself claims all the collections of the first instalment. On collection of each subsequent instalment, the member who bids for the lowest amount receives that amount and the balance is distributed among the remaining fraternity. It is obvious that on each occasion, the most needy among the bidders will make sure of his loan by bidding for the lowest amount. In the Prize Chit, a fixed sum or prize is drawn by lot and the balance is disposed of in the same manner as above. When a member has once made a successful bid or drawn a prize, he drops out of all subsequent bids or draws and thus every-one is assured of his turn. It is clear that while the former type of chits may be described as "useful institutions which have arisen under conditions of defective credit arrangements, exhorbitant interest rates and faulty communications,"* the latter is nothing of a credit institution but a mere lottery. Two grave defects vitiate all chits. The

* P. 285. Madras Report.

amounts received ultimately by members must vary in an arbitrary manner. What is more serious, once a member or particularly a promoter has received his amount, he has every inducement to wish and intrigue for a premature demise of the Chit. The Madras Banking Enquiry Committee were perfectly justified in their conclusion that "no attempt should be made to foster their development if they show signs of dying a natural death."

III

BANKS AND INDUSTRIAL FINANCE

An industrial or commercial enterprize has a double financial problem. It has to raise adequate permanent capital to finance its fixed assets and to obtain temporary or seasonal credits, either of a self-liquidating character or to be repaid by a subsequent issue of more permanent capital. In so far as minimum stocks of finished goods or raw materails, etc., have to be maintained to assure smooth, uninterrupted working of an enterprize, these must be included among fixed assets and therefore financed out of permanent capital.

Major Industries

It is the traditional sphere of commercial banks to supply working capital to industries out of their short-term deposits. It is difficult to judge how far the Imperial Bank and the Indian joint-stock banks are able to render adequate financial assistance of this kind. The main major industries to be financed in this manner are jute, cotton, iron and steel, coal and a few others of less significance. The enormous but compensatory variations in the cash and advances of the Imperial Bank which follow closely changes in the agricultural seasons seem to indicate that steady but continuously revolving advances such as these industries need do not form a large part of its assets. It concentrates more on seasonal movements of crops and raw-materials and less on the working capital requirements of industry. The advances of Indian joint-stock banks which do not show any seasonal trend are presumably used for financing of the self-liquidating but ever-renewed needs of industry.

Complaints made before the Banking Inquiry Committee on this subject may be presumed to throw some light on the existing situation. It was alleged that in making loans, banks are willing to take account only of tangible and easily realisable assets like stocks, etc., but not of block capital. They are not inclined to offer loans on personal credit and character although the offer of mere promissory notes enables them to include such loans in their balance-sheets under the head "secured loans". Margins as large as 30 per cent. and much more are claimed and enforced against tangible and realisable assets. Many banks do not maintain the expert and technical staff required for a proper evaluation of assets and to that extent industry does not obtain the full advantage of its security. The rates charged are alleged to be more than industry can bear.

Medium-sized and Small Enterprises

It is much more certain that our commercial banks have not proved very useful in meeting the short-term requirements of medium-sized and small enterprises. These industries are scattered far and wide all over the country and in the aggregate are as important, if not indeed more important, a factor in our national economy as the above mentioned major industries. They include rice, flour and oil milling, sugar refining, lac manufacture, mica mining, cigarette and silk manufacture, cotton ginning and cleaning, tea growing and manufacture, glass manufacture, brass and copper vessel industry, tanning and leather industry, blanket weaving and embroidery industry, etc. Many of these industries are reported as languishing for lack of adequate finance or unreasonably high rates they have to pay for what finance is available from loan-offices, money-lenders, mahajans, Marwari bankers, exporting firms, middlemen, karkhandars, etc.

It is an error to suppose that banks as big financial institutions must inevitably limit their interest to big industry alone. It is true that growth in the size of the industrial and business unit has been an important factor impelling, if not forcing, banks to seek similar expansion.

But the very bigness of particular industries has made them so sensitive to world factors that wise bankers seek an escape from too great a dependence on them into the better distributed risks of a smaller clientele not so vulnerable to these forces. In certain countries, big industry of its own accord has sought to release itself from the restraints of indebtedness to banks and has even added banking and financial functions to their own legitimate sphere. In the United States, the bulk of direct commercial loans is made to small or medium-sized firms, wholesalers, retailers, service trades, professional persons, etc.

The distribution of advances in England is on similar lines though not on the same scale. We may take as a typical sample the distribution of advances of Barclay's Bank for the year 1935. Of the total advances of 155m£, about 8 per cent. went to farmers and the average size of the loan was in round figures £610. Retailers obtained 8·7 per cent. of the total, with an average per head of £540. "Professional and private" advances *i.e.* loans largely for purposes of consumption and perhaps dealings in securities took away as much as 35·7 per cent. and the average size of the loans was £450 only. For a country of the wealth, commerce and industry of England, it is certainly remarkable that more than half the advances of a leading bank should consist of small loans of this kind.

These figures appear even more instructive when contrasted with the relative insignificance of the aggregate advances to heavy, big industries and their much larger per head indebtedness. Textile, Heavy, Coal-mining, Shipping industries obtained only 12·7 per cent. of aggregate advances while the average size of loans to all these industries taken together was £8,500. Coal-mining supported the largest burden of per head indebtedness—£61 thousand in round figures. Building which is such an important form of investment in all highly urbanised countries was allotted 7·5 per cent. of all advances—the average advance amounting to £1,800.

The immense range of variation in the sizes of loans may now be judged from the fact that the average size of all loans was £774 only*

Provision of Long-Term Capital

Long-term capital required to finance the fixed assets of industry is derived from three sources. As in the earlier stages of industrial development in other countries, capital subscribed privately on a family basis or from friends has played and still plays a large part in industrial ventures. The managing agency system originated in and is closely associated with this fact. Secondly, it is the practice in certain places to raise a larger or smaller part of the required capital by means of deposits which are generally fixed for one year but in many cases extend to as long periods as 7 years. These deposits are naturally strictly local in character since their chief basis is the reputation for business integrity or social and caste affiliations of the management of mills. Finally, we have the more general and fast growing method of direct appeal to investors through prospectuses, etc.

The method of direct appeal to investors suffers in India as everywhere else from two defects. The supply of capital is forthcoming not at a steady rate but in sudden sporadic waves. These waves occur at times when some events create such unusual states of mass expectation that the usual motives of prudence and caution are weakened and the investor surrenders to the lure of quick and large specula-

	* Percentage of Advances. Barclays 1935	Average Size of Loans. Barclays 1935.	Average Size of Loans. Lloyds 1926.
Farmers	7.9	610	881
Textile	1.1	......	15,856
Clothing	1.9	......	......
Heavy	4.9	1,800	......
Building	7.5	1,800	......
Food	1.7	......	......
Coal-mining	5.0	61,000	12,925
Others	2.7	......	......
Merchants (Raw	2.6	......	......
" (Manu.)	2.7	......	......
Retailers	8.7	540	610
Hotels, Laundry	2.5	......	......
LLoc. Govt. Pub. Ut. ...	4.2	......	5,484
Shipping	1.4	......	......
Finance, Insurance ...	4.9	......	......
Professional, Private	35.7	450	545
Entertainments, etc. ...	4.6	......	......
Average Advance	...	774	500

tive profits. In the recent history of capital issues in this country, the years 1920-21 and 1935-37 stand out as illustrations of this fact. Enterprises whether new or old have to wait for such golden opportunities or else raise capital in ways which are onerous.*

A much graver defect of this system is the lack of guidance to the general run of investors. Even in a country like England in which there has always existed a large class of investors with means to invest who are accustomed to exercise independent judgment as to what to invest in, large quantities of capital run to waste. As the MacMillan Committee record,† the shares and debentures of 281 companies which raised on them 117 m£ in 1928 had a market value of only 66 m£ in May 1931. As many as 70 of these companies had been wound up by that date and the capital of 36 others had no ascertainable value. If details of what happened to the flotations of 1920-21 and 1935-37 in India were compiled, the outcome is not likely to turn out less ghastly.

When conditions in the capital market are temporarily unfavourable or the requirements are only temporary or adequate capital willing to undertake risks is not forthcoming, the issue of suitable debentures is a legitimate method of raising the needed finance. It happens, however, that debentures are not as popular in India as elsewhere. Among the more important causes of this backwardness are the unfamiliarity of the general public with this form of investment, the preference of the more business and money minded classes for speculative scrips, heavy stamp duties on debentures and on transfers of debentures, lack of confidence in all but the largest,

* Capital Issues (in crores)

1918-19	21.2
1919-20	281.7
1920-21	148.0
1921-22	80.8
1922-23	24.9
1923-29	......
1932-33	30.2
1933-34	50.8
1934-35	36.4
1935-36	46.2
1936-37	109.0
1937-38	53.1

† P. 166.

best-known and well-established enterprises, the ensuing concentration of debentures in the hands of our potentates, merchant princes and other wealthy clients, and finally the avoidance of such investment by insurance and other cognate concerns with large investible resources.*

The practice of raising capital by means of deposits fixed from one to seven years is an outcome of local ties and confidence and its extent for that reason varies from place to place. The Ahmedabad industry depends on it most, indeed, to such an extent that neither fixed nor liquid assets of the industry can be used as security for loans from banks or from any other quarter without undermining the whole credit structure.† The Banking Enquiry Committee (1931) found that there had been no reduction in the total of deposits received by Ahmedabad textile mills during the previous 25 years. It is still a point worthy of consideration whether continuance of the system is not fraught with grave dangers, particularly in times of depression. These deposits have been described very appropriately as fair weather friends, attracted by generous offers of interest but likely to fall into a stampede at the slightest approach of danger. Their replacement by share or debenture capital is much to be desired as abrogating a weak link in the industrial structure of the country.

Commercial Banks and Industry

Banking funds reach industry through several channels. There are in the first place, short term advances made

* Pp. 273-75. Banking Inquiry Committee's Report.

† Percentages of Total Finance.

	Bombay (64 mills)	Ahmedabad (56 mills)
Amount loaned by mortgage-agencies	21	24
Amount loaned by banks ...	9	4
Amount by public deposits ...	11	39
Amount of share-capital ...	49	32
Amount of debentures issued	10	1

	Interest-rate offered by a mill under a particular management in Ahmedabad.	Yield of 3½ p.c. Govt. Security on April 1st of the year	Average bank-rate for the year.
1923 ...	6	5.7	5.96
1926 May ...	5½	4.4	5.72
1927 Jan. ...	5	4.4	5.72
1929 Oct. ...	5½	4.9	6.32

Banking Inquiry Committee Report, p. 278.

directly. Secondly, a good deal of commercial or instalment paper which banks discount results in financing industry either directly or through intermediaries. Loans given to brokers or customers to enable dealings in or holding of stock exchange securities ultimately find their way in a similar manner to these enterprises as share capital or other kinds of capital.* Finally, direct investments by banks in industrial scrips or temporary loadings which occur in the course of underwriting or issuing activities are apt to reach large or small proportions according to the traditions of each banking system.

It is not a matter of indifference whether these funds reach commerce and industry through one channel or another. If direct loans give place to indirect methods of finance, industry is released from the healthy check and experienced guidance of bankers who in their turn must also suffer from loss of direct contact. If loans to brokers and customers take the place of direct investments in industrial and other scrips, banks are automatically involved in the severe speculative waves of stock exchange dealings. Not only the technique and methods of bank finance have then to be re-adapted but the quality and stability of the banking business as such tend to alter in an important manner.

It is a tradition, particularly of British thought on the subject to distinguish broadly between short term and long term finance and to argue that deposit banks should limit themselves to the former. The policy is partly justified by the natural rule of prudence that short term deposits—and British banks are known to hold particularly large proportions of short-term deposits—should be used to finance short term requirements. Besides, there is also the feeling that short term finance assures safety in a manner and to a degree which cannot be expected of long term finance. It is necessary to analyse this belief carefully so as to place industrial financing in its proper perspective.

It is self-evident that the banker does not and cannot seek an ultimate repayment as such. His profits are main-

* Chapter XI, pp. [illegible].

tained only by continuous repayments and continuous re-investment in such a quick succession that only a minimum of his resources is idle at any time. From the standpoint of maintenance of a steady social output, a repayment means a successful advancing of goods to a further stage of production and a re-investment means acquisition of materials from an earlier stage for further fabrication. A failure to repay means that goods have been created which are not able to find a market and a failure to re-invest means an accumulation of idle stocks which fails to be absorbed into the productive process. In case of failure at any stage, adjustment has to take place by a fall of prices at all earlier stages and distribution of incidental losses through the production and banking structure. Looked at in this way, the difference between short-term and long-term finance reduces itself to the simple fact that a short loan involves estimation of the possibilities in the very near future only. A long-term loan raises more complicated questions. The banker must estimate in the first place the prospects of a particular industry over a long period and secondly the prospects of the particular firm with reference to its own special circumstances. Even if mistakes are detected, there is but limited opportunity for periodic revisions of judgment, once the investment is made. Besides, when an enterprise is new, a relatively long period of incubation and immaturity must elapse before the investment will bear fruit. In the case of a tea garden, for example, production does not commence till after the expiry of four years from the laying out of the garden. For some other industries, periods of ten and even twenty years may be necessary. Hence, even when investments are prudently undertaken and properly diversified, sporadic and individual factors may land the banker into serious embarrassment.

It is only in this sense that we can ascribe "liquidity" to the short-term advances of a bank or banking system and claim "a solid residium of truth in the older doctrine that the banking system is less vulnerable and more stable

if the individual banks are in a genuinely liquid condition." There is, however, another sense in which the word "liquidity" is sometimes used. The assets of an individual bank are described as liquid when they can be readily exchanged for cash. Government securities for example are specially prized in this country as assets of this kind. Since government themselves are not expected to repay, it is clear that liquidity means here a high degree of marketability or shiftability . This shiftability has its own well-marked limits. An individual bank can dispose of its assets to the public or to another bank; all banks taken together can shift them within the limits of law and practice to the central bank, if one is in existence. In certain circumstances, the banking system of a country may be able to invoke the aid of foreign banking systems for the same purpose. But except within these limits, there is no such thing as liquidity for the banking system as a whole, whether the phrase is understood in the first sense or the second. If every bank were to decline to renew its loans or to endeavour to place on the market its assets on any substantial scale, a complete break-down of the economic system could be the only result.

Although loans to finance fixed assets of industries are not liquid in the first sense, the shares and scrips representing them are certainly liquid in the sense of shiftability. This shiftability, however, is apt to hold true in many cases only in the literal and not economic sense. For reasons discussed elsewhere, grave instability of values is almost inseparable from scrips which figure in stock exchange dealings.* Recent experiences illustrate very forcefully the waves of appreciation and depreciation to which these industrial investments are prone. The index-number of maximum prices of ordinary shares stood at about 102 in 1929, fell to 58 in 1932 and flared upto 128 in 1937. Considering minimum prices, the index-number was 93 in 1929, 63 in 1931, 37 in 1936 and 108 in 1937.† Even more instructive for the life history of a bank are the

* See pp. [illegible].

† P. 25. Review of Trade. [illegible]

vicissitudes of investments taken over by the Central Bank of India from the Tata Industrial Bank. The following figures speak for themselves.

No. of Shares	Name	Pd.-up value	Mkt. value adopted in Dec. 1924	Market value Dec. 1939
24378	Tata Iron (2nd Pref.)	100	20	184 8 0
11562	Nira Valley Sugar Co.	100	1	...
828	Tata Power Co.	800	95	1376 4 0 (Pd.-up 1000)
19250	New India Assurance	25	11-12-0	85 2 0 (Pd.-up 15)

If ultimate solvency were the criterion of sound baking few banks need fall into difficulties on the ground of industrial finance. Unfortunately, banking business is different from all others because it has to be solvent every minute of its existence.

These difficulties which are partly economic and partly technical are sometimes held to suggest an inevitable bifurcation of the banking system into separate institutions for short-term and long-term finance. There is, however, hardly an example in economic history where such a separation of banks has existed and has expedited industrial and economic progress. On the contrary examples of countries which adopted mixed banking and hastened their industrialisation are more numerous.* The exceptions are not countries which have a bisected banking system but countries like England in which an independent class of investors with means and judgment to invest ante-dated a commercial banking system which grew on industries already in existence. Prudence, therefore, suggests that we should analyse in detail the exact strong and weak points in mixed or integrated banking before supporting the alternative offered.

There should be no question but that long-term investments should not be financed to any appreciable extent out of short-term deposits. In other words, banks which embark

* Mac-Millan Committee's Report, paras, 337; 378 379; 380; 381.

on industrial finance should take care that such investments are well within the fixed and long-term funds at their disposal. Expansion of such activities should be preceded by an adequate proportion of capital and reserves and acquisition of funds on a longer basis than suits the book of ordinary commercial banks. That this proportion need not be excessively high is proved by the Banque D'Affairs of France whose ratio of capital and reserves to deposits has been well within 30 per cent. and is about three times as high as in the case of ordinary commercial banks.*

Sources for such funds are by no means insignificant even at present. A proper scheme of co-operation between government, the Reserve Bank and commercial banks should release large funds for use in industry which are at present either idle or are diverted into less useful channels. Postal cash certificates issued by government for example absorbed about 35 crores between 1920-30 as against a net increment in paid-up capital of joint stock companies of 150 crores. Between 1930 and 1937, joint stock companies showed an increment of about 29 crores only as against 26 crores attracted into cash certificates. It is perhaps undesirable that such large funds should be absorbed by government when certificates and debentures of well-established banks could as well serve the purpose of attracting into productive channel these dormant resources. Precedent for such a departure exists in Switzerland where commercial banks issue debentures of 3 to 5 years, changes in interest rates being regularly notified to and approved by the Swiss National Bank. Power to permit the issue of such debentures and the rates at which they are issued may well lie with the Reserve Bank which should be the best judge of the character and policies of the banks concerned. The extent to which

* Banques D'affairs

	1936 Dec.	1938 Dec.
Capital and Reserves. (Million Frs.)	1,078	1,118
Deposits. (Million Frs.)	4,115	3,818
Cash and at Bank. (Percentage of liabilities) ...	19.6	23.7
Loans and Advances. (Percentage of liabilities)	30.9	25.7
Discounts. (Percentage of liabilities)	31.6	35.3
Investments and Premises. (Percentage of liabilities)	25.1	28.2
Acceptances etc. (Percentage of liabilities) ...	4.5	5.9

industry raises capital in the form of deposits in certain parts of the country points to another source of funds which has not been yet fully tapped. Another indication in the same direction is the recent rapid growth in savings accounts of many important banks. The creation of this facility has for its object the extension of the banking habit to lower income-classes and its astonishing success in post-war years in many advanced countries like the United States, Sweden, Norway, etc., should leave no doubt about its future in India as well. The average period for which deposits are fixed in India is much longer than in many Western countries, and decidedly longer than in England where shorter deposits, perhaps as short as 14 days, form the great bulk. The adaptation of the structure of certain Indian banks so as to fit them for venturing into the field of industrial finance should not for these reasons be found materially difficult.

Participation of commercial banks in industrial finance and flotations offers certain advantages which should not be under-rated. In the case of established industries, their usual business of short-term finance brings them into contact with their own special problems as well as the problems of allied or dependent industries. Through their large number of branches and through their connections with all markets and lines of business, they are able to judge the prospects of each enterprise against a comprehensive perspective of the economic milieu as a whole. No other agency is better qualified to offer advice and guidance on long term policies, on questions of extension, amalgamations, etc., and no other agency is better situated to bring appropriate pressure for their adoption. While any tendency on the part of banks to manage industry is to be deprecated, their supervision of and informal association with the financial policies of industry should certainly redound to the benefit of the large investing public whose enforced or voluntary abdication of functions and responsibilities is a standing reproach and scandal of the so-called "financial democracy" of joint stock enterprise.

In the case of new enterprises, their active participation may prove even more beneficial. The gravest defect of the present system of investment is the absence of any reliable guidance to the investor. The stock-exchanges are more a barometer of fears and hopes about the future generated by the passing events of the present than a balanced long term view of the future itself. Unlike individual brokers or firms of stock-brokers, banks are immortal institutions with reputation and traditions to maintain. They are unlikely to give the prestige of their support and recommendation to doubtful issues, still less to underwrite them. Banks can afford to gather information, maintain records, employ specialists such as may not be expected of small firms.

It is sometimes suggested that the check of a single bank which supplies both short-term and long-term finance may not prove as efficient and impartial as the multiple check of one institution which supplies fixed capital, another which supplies short-term finance and so on. The suggestion springs from two assumptions both of which seem groundless. It is assumed that the parties which supply fixed capital or are connected with it exercise some check at present. As a matter of fact, neither investors nor stock-exchange authorities are to any degree effective. In the second place, it is taken for granted that participation in issues and flotations means a permanent connection with individual enterprises. As a matter of fact, the ideal should be as rapid a change in the composition of the investment portfolio as market conditions and circumstances permit. The ultimate holder of securities should be the public and not banks—the latter only correcting the tendencies of investment to occur in sporadic waves and other defects.

There is nevertheless a danger that while a bank holds an interest in the fixed assets of an enterprize, it may be tempted to offer much more short-term accommodation than a strict view of the circumstances and ordinary business caution will justify. Similarly, capital extensions might be undertaken more in the hope of extricating itself from unwise commitments whether on account of short or long

loans than to place the concern on sounder footing as such. It will be seen later that complications or suspected complications of this kind lay at the root of the ultimate disasters which overtook the People's Bank of Lahore, the Bank of Burma and the Tata Industrial Bank. But on closer analysis it will be realised that this is a danger not of combination of short-term and long-term finance as such but of the interlocking of authorities. Even today, the men who sit on the boards of our commercial banks are generally men who have deep stakes in the industries of the country. As the aforesaid failures revealed, the men and concerns which were responsible for banking ventures were more often than not the very men and concerns which sought to pioneer industries in this country. The ultimate cause of this interlocking is partly the paucity of high business talent as such and partly the circumstances which confine access to economic power and experience to a few families or narrow social circles. Until it is possible to enforce a rule that officers of banks may sit on the boards of companies as representatives of banks and in no other capacity, an alleviation of our present difficulty could be sought in associating as a rule more than one bank with any issue. Such consortiums have been common in Germany and they are to be desired not only as supplying a multiple check but as enabling a wider distribution of risks.

Post-war changes in the outlets for banking funds are putting pressure on banks in the same direction. Even in a country like England, industrial and commercial advances of banks are becoming a diminishing proportion of the whole and it is only an expansion of "other" loans which has enabled them to maintain their advances somewhere in the neighbourhood of their accustomed volume.* The

* British Clearing Banks.
(Percentage of Total Advances).

	1929-30	1936	1937	
Industrial and Commercial Advances	55.5	47.2	46.2	e.i. Textile, Heavy Agriculture, Mining, Food, Drink, Shipping, Bldg., Retail, Misc.
"Other Advances."	44.5	52.8	53.8	Loc. Govt., Pub.-General. Uti. Amusements.Clubs,Churches. Charity

causes which have brought about this situation vary from country to country. In some, direct investment has received a severe check on account of the complete break of values in the crisis of 1929-30 and 1936-37 and fixed deposits are much preferred to shares and equities. In others, as we have already said, industry raises its working capital directly, seeks to increase the rapidity of turn-over and maintains smaller stocks—in order to escape dependence on banks. This should explain why in some countries loans to brokers and customers for security dealings grew so rapidly and in others, large funds were driven into real estate loans. It may well be that in these countries, industrial finance may assist banks to create new outlets for investment and at the same time restore direct touch between banking and industry. As the MacMillan Committee say very truly, "in any community which wishes to keep in the van of progress, the financial and industrial worlds should be closely integrated through appropriate organisation."*

We have already noted how the problem of outlets for investment of funds which was already acute in pre-war times has become seriously aggravated in post-war years.† There is some evidence that banks are changing their investment policies in the direction of industrial finance already. Of the Big Five, the Allahabad Bank does not venture into any investments except government securities. But the other four have been gradually increasing their investments in debentures and ordinary and preference shares, of joint-stock companies. About 2 per cent. only of their deposits in 1924-25, the proportion has risen steadily to a little above 5 per cent. by 1937-38. This is certainly a very conservative position since the capital and reserves of these banks are apt to be above 9 to 10 per cent. A reference to the balance sheets of Banque D'Affairs will show that their investments and premises are almost identical in amount with their capital and reserves.‡ A

* Para, 885.

† P. 182.

‡ Foot-note, * p. 157.

little more than two-thirds of their deposits are invested in short-term finance *i.e.*, discounts and advances which shows what a large part ordinary commercial banking plays in their activities even. In absolute figures, the industrial stake of our four big banks is very small, being about 3½ crores in all. But the steady increase from ½ a crore only is certainly a pointer. Even this small amount, if it is constantly turned over from one scrip into another is not insignificant since, except in years of investment booms, the net increment of paid-up capital of joint-stock companies rarely exceeds 5 crores in a single year.

Industrial Banks and Small Industries

In consequence of the foregoing facts, it would be otiose to discuss whether long-term finance for big industrial enterprises could not be better supplied by a special type of banks. Proposals have been made by the Central Banking Enquiry Committee* and by others for provincial or all-India industrial corporations. Although the Committee does not indicate the desirable amount of share capital, and merely suggests that debenture capital should be twice the amount of share capital, it is to be presumed that such corporations are intended to have quite large resources. Now, as we have already seen, even industrial banks depend for their success and profits on quite a large proportion of short-term resources and short-term finance. In the present circumstances of the country, such large, short term resources can be acquired only at the expense of existing commercial banks. Such proposals overlook the basic fact that the question of industrial finance, whether short-term or long-term, has arisen here as elsewhere out of the paucity of mobilisable capital of both kinds. A multiplication of institutions presumes on the other hand a relative abundance of funds. It is the basic justification, central object and outstanding merit of mixed or integrated banking that it enables a country to make an economic and intensive use of its limited capital resources.

* Paras, 401 to 418

Although specialised industrial banks might not be feasible or desirable for large enterprises, it may be that they have important services to perform towards small or cottage industries. These industries labour under certain special difficulties which repel the bigger banks from supplying them either short-term or long-term accommodation. Their shares and stocks, if they exist, have hardly any market and cannot be easily marketed, should need arise. Controlled by relatively obscure managements and existing in scattered and obscure places, the technique of financial aid and supervision has to be on a different scale and altogether different in character. Their problems of marketing are more difficult and urgent than those of production.

The history of such banks as have been floated illustrates well these various difficulties. Of the 8 industrial banks which were traceable early in the post-war year 1923, four have disappeared. The small size of one gave it the much needed obscurity in which alone irresponsible finance and fraud can thrive.* Another started well with a substantial capital but soon resorted to doubtful practices with the object of collecting deposits.† The interlocking of the Tata Industrial Bank with Tata enterprizes and the impatience of the shareholders accounted for the disappearance of the third and the greatest Indian enterprize in this line. The birth of a fourth which was a small bank was registered but its demise seems to be lost in the massive banking morality of the country.

The industrial banks which existed in 1936 and for which some information is available suggest some important

* Industrial and Exchange Bank of India, Bombay: (1920-24) Paid-up capital 2.8 lakhs. It started branches at Karachi, Surat, Fazilka, Kapurthala, and Rawalpindi. When the bank closed its doors, the debtors at Karachi were untraceable. The manager of the Surat branch was found to have used bank's funds for his own purposes. Of the total debt of 1 lakhs at the head-office, half the amount had been advanced to persons who became insolvents. One of the directors who had a decree for 87 thousand against him fled to Germany before the first balance-sheet was out and his co-signatories proved paupers. The bank underwrote the shares of the Solar Assurance Co., but they could not be sold.

† Calcutta Industrial Bank, Calcutta: (1919-28) Paid-up capital 79 lakhs. Some calls were not paid as late as 1921 and shares had to be confiscated. It 1922, it floated the Marwari Commercial Bank—itself paying its entire capital of 75 lakhs: Secretary, directors, etc. were identical. The object was to collect deposits and business for both banks but as none were forthcoming, a petition for winding-up was filed in 1922.

inferences.* Of these, only three are really noticeable. It is not perhaps surprising that their essentially local character should be reflected in their small size. The five important Banque D'Affairs of France had in 1936 merely a quarter of the capital and reserves of 8 big deposit banks of the country and their aggregate resources including deposits were only a little more than 1/11th. But these industrial banks of India could not be compared even with these Banque D'Affairs. What is more surprising about Indian ventures in this field is their inability to attract or retain deposits. The Banque D'Affairs in France depend on borrowed resources to the extent of two to three times their capital and reserves. Except in one instance, the deposit resources of Indian industrial banks hardly deserve notice.

It is clear that industrial banks as such are not able to create the necessary confidence in themselves. Indeed, the experience of certain provincial governments about such long-term assistance as they gave under State Aid to Industries Acts seems to give justification for such lack of confidence. In Madras, in Bihar and Orissa and in the Punjab, the tale is one of uniform losses of the major part of the capital supplied.† It is here that a proper

* 1936. (in lakhs.)

	Capital & Reserves.	Deposits. Fixed.	Current.	Cash	Loans and Advances	Government and other Securities.	Other. Assets
Industrial Bank of Western India ...	20+ 9	00.12 +	2.74	3.22	25.0	6.53	2.26
Karachi Industrial Bank	60+ 1	2.62	...	.57	35.5	...	36.18
Simla Banking and Industrial Co. ...	5+ 2	26.0 +	3	3.6	21.2	15.8	4.9
Luxmi Industrial Bank	1+ 1	10.0	...	0.4	5.5	...	8.6
Raikut Industrial Bank (Jalpaiguri) ...	3+ 0	0.1	...	...	1.9	...	1.6
Tezpur Industrial Bank (Tezpur) ...	0.5+0.7	2.0 +	1	1.0	3.9	...	.3

(Karnani Industrial Bank.
(March 31st 1937 : in lakhs.)

Capital	60
Customer's Accounts	2
Other liabilities	10
Fixed Assets	00.3
Investments	28.0
Investments	28.0
Bills, Loans, etc.	38.0
Cash	00.5

No dividends have been declared between 1928-1938. Current and fixed deposits were as under (in lakhs)

1928	24
1930	32
1931	18
1935	25
1936	2

† Banking Inquiry Committee' Report, pp. 306-09.

integration of the bigger commercial banks and small industrial banks is likely to confer great benefit on the country. On a basis of affiliation with approved industrial banks, the bigger banks, while limiting their direct aid to short-term finance only, could supply through their branches the necessary expert guidance and knowledge in industrial banking. The known co-ordination of relations between them will ensure proper regard for banking practice and will tend to create the necessary basis for public confidence in the smaller institutions.

IV

FINANCE OF FOREIGN TRADE AND EXCHANGE BANKS

Foreign trade between two countries is financed largely by means of bills of exchange drawn by the exporter on the importer, with banks as intermediaries to purchase or, in due course, to collect them. The financing of the foreign trade of India is distinguished by certain special features which we now proceed to note.

(1) The bulk of this business is in the hands of non-Indian banks, popularly known as exchange banks, of which there are now nineteen. Two of these are concerned largely with tourist traffic. Of the rest, five have a considerable portion of their business in India while the other twelve are only branches or agencies of big banking corporations doing the major portion of their business outside India.

Indian joint stock banks have little share in this business unless the exchange bank concerned has no branch in the interior of the country and the financing of the export or import business has, for that reason, to be split into two transactions—the financing from or to, the Indian port to, or from, the upcountry distributing or collecting centre and the financing from the Indian port to foreign port or vice versa. Indian exporters or importers naturally prefer the financing to be arranged by a single agency as being cheaper, but in the absence of an up-country branch of the exchange

bank, the first part of the financing is generally undertaken by the Imperial Bank of India, the Indian joint stock banks and the indigenous bankers in the case of exports and in the case of imports, by commission agents, shroffs and Indian joint stock banks. Demand draft is the instrument usually employed by Indian banks for this purpose.

It is difficult to estimate the actual share which Indians hold in this business. A part of the import trade is arranged with documents made out in the names of Indians instead of exchange banks as a matter of convenience but the financing is really done by non-Indians. There is also some trade which is handled without the intervention of exchange banks. Allowing for these two factors, the share of Indians has been placed by competent observers at about 15 per cent., and according to the testimony of the Exchange Banks, it is a share which is slowly growing.

The loss to this country from the predominance of the exchange banks is not confined to the financing of foreign trade as such. Other incidental losses have also to be reckoned in. There is reason to fear that branches of exchange banks, opened though they may be, at the request of Indian clients encroach on the financing of domestic trade as well. The cheap deposits raised by exchange banks place them in a strong competitive position which is further reinforced by the natural tendency on the part of their customers to open and keep accounts with them. Besides, exchange banks have been accused of compelling Indians to insure their goods with foreign companies on the usual grounds, which however plausible on their face, cannot but limit the growth of Indian enterprize in this field. With their practical monopoly of this business, it should not be surprising if non-nationals in the export and import business of this country are encouraged by them with the offer of better facilities, etc.*

(2) The Indian exporter draws bills, usually of 3 months usance and rarely longer, against credits opened by the buyer with London banks and advised to India through the medium of an exchange bank. Our export bills are as a

* Central Banking Inquiry Committee. Report. 329.

rule in sterling although in the case of Japan and China they are in terms of yen and rupees respectively. Since these bills can be and are usually discounted in London with the endorsement of exchange banks, the negotiating exchange bank here gives the foreign importer the benefit of the low interest rates of London. It is very unusual for an exchange bank to hold these bills till maturity except in times of abundant funds or slack trade in India. It is also unusual for the Indian exporter to entrust his bills to the banks for collection since it means waiting for funds till they fall due.

In the case of our imports, things work out differently. A small part of our import trade is financed by London banks' acceptance of "house" paper. This means that bills of a foreign exporter who has got the requisite standing to draw on a bank in London, are accepted by it and returned to the exporter to be discounted in the London money-market. The importing agency here which is usually a branch of the London exporting firm thus obtains the advantage of lower London rates. Since, as we shall see presently, the Indian rival of the importing agency is denied the same advantage, the procedure places him at a disadvantage in his competition with the British or foreign rival.

The bulk of our import trade from Western countries is financed by 60 days' bills drawn on the Indian importers.* The London banks which buy or advance funds on them in London, send them for collection to India. Although the bills are drawn in sterling and although they are held till maturity, the benefit of lower London rates is not given to the Indian importer. These bills have an interest clause under which the importer here is made to pay interest at a stated rate, usually 6 per cent., from the date of the bills to the approximate or estimated date of arrival of return remittance in London. The local drawee has to find local currency to cover not merely the sterling face amount of the bill but something more to purchase the additional

* Cf. "These Indian import bills......are usually drawn in India at three months' sight; there is also a fair proportion of four months' paper drawn, but not many six months' bills are taken". Eastern Exchange Currency and Finance by Spalding (3rd Edition. Pittman and Sons 1920) also Banking Inquiry Committee Report, p. 315 Para, 429a.

amount of sterling required to cover the interest. The drawer abroad eventually receives the face amount of the bill plus interest at the agreed rate.* The rate is raised when the Bank of England rate rises above 5 per cent.†

From the standpoint of the banker, the substance of these two operations may be put in this way. The discounting of the Indian exporters' bills in London releases funds immediately for transfer to India. He prefers to hold the British exporters' bills till maturity *i.e.* lock up his funds in India because they earn for the whole or the unexpired portion of the maturity a rate of interest higher than what any money market in the West can offer.

This difference in practices relating to export and import bills, calls for some explanation. It is logical that bills on India which may have to be discounted in India should bear the higher interest-rates of this country. But as a matter of fact, these bills are held till maturity and sent to India only for collection. If instead of negotiating these bills, the London banks only accept them as in the case of "house-peper," cheaper London funds could be made available for the benefit of the Indian importer.‡

Since the bills are in sterling, the question arises how the sterling amount is to be converted into the local

* Cf. "Interest is usually collected from the Indian acceptor for the estimated period the bank in London is out its money, and, if the bill is paid before maturity, interest is adjusted accordingly......It is difficult to say why some Indian acceptors willingly acquiesce in the interest charged in the interest bills, while others refuse to pay it. The reason according to some bankers, is to be found in the rules of the different castes......the dawer on this side is not the loser, and where he pays the interest himself he doubtless recoups himself in the price he charges for the goods, so it comes to the same thing in the end. " Weastern Exchange Currency and Finance. Spalding. (Pittman. 1920 3rd edition.) P. 84.

† In 1929, it was 7 per cent. for the greater part of the year and 7½ per cent. from the middle of October to the end of November. The Bank of England rate was 6½ per cent Central Banking Inquiry Report. 1931. P. 317.

‡ The difference between an "interest bill" and a banker's acceptance depends on the level of interest rates in London. Take for example a bill on India at 3 months sight—the mailing time being 15 days each way.

(i) Cost of interest bill.

	£	s.	d.
Interest for 120 days at 6% on 500	9	17	3
Indian Stamp duty	0	5	0
Total ...	10	2	3

(ii) Cost under acceptance credit.

	£	s.	d.
Acceptance commission at 1½% per annum ...	2	10	0
Discount for 120 days at say, 2%	3	6	8
Stamp duty	0	5	0
Total ...	6	1	8

If the discount rate in London is 5 per cent., the latter cost would be £11-1-8 i.e. acceptance credit would be more costly.

currency for payment by the local drawee. This is done by an exchange clause which is a special feature of the import trade with South America, India, etc. The exchange clause is a phrase included in the bill to direct the method by which return remittance is secured in sterling. Its object is to throw the risk of any loss of exchange from the drawer to the drawee. Some bills are drawn with the clause "payable at the particular Exchange Bank's drawing rate for demand bills on London." Others contain the clause "payable at the particular Exchange Bank's rate for demand bills or telegraphic transfers on London." If no rate has been arranged with the bank, the rate is that fixed by the exchange banks in India from day to day. Of course, the Indian importer can take steps to protect himself against exchange fluctuations by buying pounds forward to the required extent. This means an additional operation for which he will have to bear the costs.

(3) Bills drawn on foreigners by Indian exporters are usually D/A bills. In other words, when a bill is accepted by the foreign importer, of course, through the medium of banking houses as explained above, the documents accompanying the bill are handed over to him and he is able to obtain immediate possession of the goods. The payment may be postponed till the bill matures.

Bills drawn by foreigners on the Indian purchasers are usually on D/P terms without letters of credit. Technically, the Indian importer is not entitled to obtain possession of goods except on payment. The difficulty has been met by requiring the importer to execute a Trust Receipt by which he agrees to hold goods or their sale proceeds in trust for the banker until payment is completed.* The advantage from the banker's standpoint is that in case of failure to pay, a criminal liability is added

* Cf. "......from the standpoint of British Banking we have no hesitation in saying that trust receipt facilities are open to grave objection......The trust receipt system...is said to have been evolved in the United States ('where the law recognised to a far greater extent than elsewhere the bank's property in the goods after they are given up to the acceptor of a bill') but something akin to it is seen in the cotton and woolen manufacturing districts of England, where it is no uncommon thing for the raw material to be delivered on the signature of a trust document before the bills of exchange are paid." Foreign Exchange and Foreign Bills. (3rd edition. Pittman.) Pp. 183; 185. Also pp. 181; 185.

to the civil liability enforceable on the bill. A recent decision of the Madras High Court seems, however, to throw doubt on this remedy since a bank is apparently required to prove actual loss to the bank or likelihood of loss arising from the fraud of the executants.

That the foreigner should receive entitling documents on mere acceptance while the Indian should be required to execute an additional safeguard like a trust receipt and incur the additional cost of it is certainly an invidious discrimination. The exchange banks defend the practice on the ground that the Indian importer is usually a man of limited means whose credit would not justify the other practice.* Exchange banks themselves, it must be recorded, are not uninterested in the discontinuance of the discrimination since loans against trust-receipts fetch a higher rate of interest than loans against bills.†

It is more than probable that the issue turns mainly on the kind of bank references given about Indian businessmen. There has always been a feeling that these are not as satisfactory as they should be. Otherwise, D/A bills should find no difficulty in passing current in our import trade just as in our export trade. Lack of personal and social contact between the European officers of exchange banks and Indian businessmen is only a part of the difficulty. The belief of Indian businessmen in the virtue of secrecy in business, their unwillingness to have their balance-sheets prepared and audited by qualified accountants are further aggravating factors. Even so, the fact that in opening a confirmed credit with an exchange bank, the best Indian importing firms in Calcutta are required to deposit 10 to 15 per cent of the value of goods ordered while the rival European Houses are exempted from such requirements is a clear proof that mere racial prejudice plays not a little part in the situation. It is no satisfactory reply to say that 9/10ths of the imports business is done without such credit and that the complaint relates to a

* Banking Inquiry Committee Report p. 323.

† Ibid, p. 323.

only a small part of the business. The principle involved remains unaffected.*

Foreign Banks Generally

The existence of foreign banks in this country may be approached from three different angles. Firstly, it is necessary to consider whether foreign banks should enjoy a footing of equality or whether Indian interests require any special conditions or restrictions to be imposed on them. Secondly, it should be ascertained whether there exists, as claimed by foreign banks, a division of functions between them and the Indian banks and how far any such separation of sphere can be enforced by legal or administrative means. Finally, we must explore how far Indian participation in the financing of foreign trade is hampered by the existence of these banks and what means could be adopted to give them a reasonable chance of holding their own against the competition of these foreign rivals.

Status of Foreign Banks

As foreign banks are not incorporated in this country, they are not subject to the requirements of the Indian Company Law. Any grievance on this ground however cannot be more than formal since the conditions prescribed by our Law are not in any way onerous. Exchange banks should not find it difficult to submit like other banks annual statements of their assets and liabilities. The only special feature which should be insisted on in their case is that they must make separate returns in regard to their Indian and non-Indian business. This separation is necessary to enable an easy ascertainment of the position of Indian interests in the aggregate interests of the banks.

It has been sometimes suggested that in case of failure of any exchange bank, the interests of Indian depositors and creditors stand in need of some protection. Recent

* Several other small complaints were placed before the Banking Inquiry Committee. It was said that alterations were made in the rules of business and were not promptly communicated to the clients. (P. 824) Till recently, penalties for the late completion of exchange contract were different in Bombay and Calcutta. (P. 825) Foreigners' drafts on Indian importers held by exchange banks are not allowed to be paid by means of (a) importers' cheques on their London agents although funds are known to be available there or by (b) T. T. of other exchange banks on London or by (c) demand drafts of other exchange banks. The ground for declining is of course that it will give no profit to the collecting bank. (825) Unlike British importing firms, Indian importers are notified the arrival of documents and asked to go in person to the exchange banks to complete the formalities on the ground that no special clerks attend to this business in an Indian firm and that the clients are not available after even five or six visits by the representatives of the exchange banks. (P. 827).

difficulties in the location and distribution of assets between creditors in British India and in Native States give some relevance to the argument. It has to be observed however, that the contingency contemplated is a very remote and almost theoretical one. Short of a great war or political upheaval, no ordinary causes are likely to overthrow these institutions.

It is difficult to suggest other restrictions which may not in the end recoil on Indian banks themselves. Indian banking must sooner or later extend its activity into foreign countries. Anything which should provoke retaliation against them must make such progress difficult. If any restrictive measures are adopted here, the only objective should be to secure reciprocity for our banks abroad. An example justifying such reciprocal restrictions is the insistence of the Bank of England on two British signatures, one of which must be that of the acceptor, as a condition precedent for re-discount.

At present, foreign banks have for their avowed object the financing of foreign trade. They claim that their branches in the interior of the country have been created only at the request of their Indian clients and only in so far as they subserve their main business. This argument regarding the demarcation of their special sphere has been somewhat weakened as one Indian bank at least has been now acquired by an exchange bank.

Indian banks have serious complaints to make of their competition in the sphere of domestic trade. They have cause to fear such competition. Their enormous goodwill and prestige, their great hold on those customers who have large interests in the foreign trade of the country, their vast capital and reserves enable exchange banks to raise deposits here at very cheap rates. It is felt as a grievance by Indian banks that Indian funds should be used against themselves for the encouragement of foreign firms and traders.* It may be noted however that the deposits of exchange banks have shown in recent years no improvement relatively to other banks in the country.

* Banking Inquiry Committee Report, pp. 335-336.

Perhaps, a system of licensing of new branches under the auspices of the Reserve Bank of India should be a sufficient assurance against further encroachment by exchange banks on domestic business. The value of any protection of this kind must not however be exaggerated. Under the present constitutional arrangements no prohibition is possible against the acquisition of interest in or even purchase, lock, stock and barrel, of Indian banks themselves.

In lieu of or in addition to licensing of branches, it has been sometimes suggested that restrictions should be placed on the aggregate volume of Indian deposits which exchange banks may raise and use. These suggestions are sometimes inspired by the belief that Indian funds are used to supplement the resources of these banks for their business abroad. There is little evidence to substantiate this belief. On the contrary, it is probable that funds from abroad flow into this country, although not in insufficient volume, to prevent high seasonal fluctuations in the rates. If restrictions are placed on the deposits of exchange banks, they must inevitably ensue in raising still further the cost of finance which must ultimately fall on the Indian trader. The deposits which are declined by exchange banks will no doubt flow in the first instance into Indian banks but when the exchange banks suffer from shortage of funds, the same deposits will find their way back to them—at higher rates and to the inconvenience of Indian trade.*

It is the natural aspiration of Indian enterprize to increase its share in the financing of foreign trade. With this object in view, several proposals have been put forward.

The most direct way to increase our participation in this business would be to acquire a share in the control and profits of the exchange banks themselves. It is thought that if exchange banks were compelled to register themselves with rupee capital, such acquisition of shares by Indians and their representation on Boards of Directors would be facilitated and quickened. Such changes may have, it is to be feared, undesirable consequences in other directions. The separation of Indian interests from their

* Banking Inquiry Committee Report, pp. 335-36; 338-; 340.

foreign interests might seriously curtail the size and prestige of exchange banks and destroy their acces to the London market which is as we have seen an essential condition of efficiency and success in this field. Informal association of Indians in the Indian side of their business may be a preferable first step which in the course of time should pave the way for a more organic co-operation between Europeans and Indians.

There is another line along which progress could be hastened with benefit to both the parties. It is well known that exchange banks have as a rule refrained from employment of Indians in the higher and responsible posts. Cashiership is the highest position to which Indians may aspire in the present circumstances. The fact that their employees in the higher grades are recruited with a view to employment all over the world need not work as a bar to the employment of Indians in something better than clerical posts.

It should cause little surprise if Indian banks have failed or encountered difficulties in developing this side of business. It has sometimes been argued that funds of Indian banks already find ample employment in internal finance and at rates much more lucrative than what the business of foreign exchange carried on in the most highly developed money-markets of the world can offer. As a matter of fact, the only bank of whom this statement may be said to hold true is the Imperial Bank of India particularly as it existed before 1935. But as applied to other banks, this argument seems rather overdone. They have a steady business but in the absence of sufficient liquid assets, they have to hold too large a proportion of their funds in government securities. Since financing of foreign trade involves dealings in draft or bills of three months' maturity at the most, a movement of some of the Indian banks into this business should mark an improvement on the existing conditions. There are, however, other difficulties to be taken account of. Sale and purchase of foreign trade bills imply constant accumulation and transfer of funds between domestic and foreign centres—in both of which, therefore,

banks must have branches to manage and employ them. But foreign branches mean political and currency difficulties which are surmounted partly by inviting and making use of foreign deposits at the other end. The acquisition of foreign deposits is a task made difficult by the prestige power and size of the established rivals. German banks confronted with the same difficulties late in the 19th century devised various friendly arrangements with local indigenous banks and, to obtain full employment and adequate profits for their funds, added advances, issue and promotion business to their purely exchange work. They attracted custom by offering longer term credit and being in other ways more accommodating. Even then the cheap funds of the London money market more than offset British stamp duties, British brokerage and profits and the cost of an extra exchange operation! The task before Indian banks is today much more formidable. Its successful performance could be undertaken only with the co-operation of all Indian banks under the leadership of some one bank like the Imperial Bank of India or the Bank of India. Both these banks have large resources and satisfy the condition of a high degree of liquidity. If a scheme of co-operation were worked out, either of them could act abroad as the agent for all Indian banks undertaking this exchange business.

Lack of trained abilities to deal with the difficult and highly technical work of foreign exchange need not be an insuperable difficulty. As the Governor of the Imperial Bank of India testified before the Banking Enquiry Committee, the creation of the requisite staff should not involve much delay. The risks of foreign exchange business have been felt as another obstacle in the way of this development. But except in times of upheaval, the ordinary precaution of obtaining cover both ways should be sufficient to protect banks from exchange losses.

On account of its large capital and deposit resources and its established status in London, the Imperial Bank of India has been thought of as the best agency available for the purpose. It is a moot point whether its exclusion from foreign exchange business till 1935 was devised in the

interests of public funds which it held or in the interests of exchange banks whose balances it used to hold. It has been suggested as a counterblast to Indian suspicions on this point that their anxiety to saddle the Imperial Bank with exchange business is inspired by a desire to relieve themselves of its competition with them in the finance of domestic trade. Whatever the truth in these charges and countercharges, its conversion into an exchange bank must be considered in relation to all the banking needs of this country.

When the decision is taken to convert it into an exchange bank, its Indian character and personnel will have to be assured first. The Banking Enquiry Committee suggest a statutary provision of 3/4ths Indians on Local Boards, a majority of Indians on Central Board and complete stoppage of recruitment of non-Indian staff. As an inducement to the Imperial Bank to agree to these conditions, the Bank might be made the offer of appointing it as agent for the Reserve Bank in all places where the latter has not got its branches. The privilege confers a substantial advantage in that it means great prestige and enables the bank to attract deposits on relatively cheap terms.

As an alternative to this scheme, the Indian Banking Enquiry Committee proposes the creation of a bank on the initiative of Government. A large capital of 3 crores is suggested, to be offered in the first instance to Indian banks for subscription. The participation of Indian banks in the scheme is an assurance that the branches of the new bank in the interior of the country will not encroach on their present business and deprive them of their profits. To give prestige to the new institution in the public eyes, it may be entrusted with the management of the remittance business of the Government under the supervision of the Reserve Bank of India. The guidance and direction of the Reserve Bank are necessary since the remittance business involves considerations of currency policies from time to time. The Bank should not be allowed to make profit on this business since any competition with the existing exchange banks with the aid of government funds might provoke them to

combined retaliation. The Government might exercise the right to appoint a majority of directors if it is has to subscribe more than 50 per cent. of its capital.*

In the meanwhile, Indian banks which are in a position to do so should establish their agencies in great financial centres like London. As suggested above, co-operation among them promises the best chance of meeting successfully all difficulties which lie in their way.

V

FINANCE OF AGRICULTURE†

In spite of remarkable industrial progress in recent years, agriculture still continues to contribute almost the whole of our annual wealth.‡ The requirements of agriculture therefore overshadow all other requirements and determine directly or indirectly credit conditions in the country as a whole. It is not possible to estimate within reasonable margin of error the total volume of requirements from season to season. Some clue is afforded by the fact that the Banking Enquiry Committee placed total agricultural indebtedness before the crisis of 1929 at 900 crores—a colossal figure which must have increased still further in post-crisis years. If the indebtedness is placed today at 1,200 crores, it should mean a burden of more than Rs. 50 per cultivated acre in the country. It is doubtful whether the gross value of the produce raised per acre per annum is more than 3/4ths of this burden.

The extent of credit facilities available to any class and the price to be paid for them are largely determined by the following factors—the size and probable duration of the loans, their avowed purpose and actual use, the security offered or presumed, the degree of continuous access to information about the progress of each enterprise etc.¶

* Banking Inquiry Committee Report, pp. 349; 361; 509.

† See also pp. 280-88; 403-410.

‡ Percentage of Population in Non-agricultural Industries.

1901 ...	23	1921 ...	18
1911 ...	19	1931 ...	17

¶

	Population supported by Agriculture.	Net Acreage cultivated.	Acreage per head of population supported by Agriculture.	Acreage per tenant or Owner Cultivator.
	m.	m. acres.		
1901	155	199	1.28	...
1911	173	215	1.24	...
1921	183	212	1.15	...
1931	190	228	1.20	4½

For reasons which need no elaboration here the Indian agriculturist falls grievously short of ideal conditions on every one of these several heads. In these circumstances, the modern bank, competent to deal with clients who reach some standard of literacy and business habits, has necessarily to retreat before the money-lender and indigenous banker.

An effort was made to remedy these defects by substituting through co-operative credit societies group responsibility born of residential and social ties for individual responsibility. Apart from lowering somewhat rural interest rates, the effort has not achieved much. At the very best, co-operative credit societies have not attracted more than 10 per cent. of the agricultural families in any province while in some the proportion is as low as 2 to 3 per cent.* Their relative lack of success is to be ascribed to two main omissions. Co-operation attacked the problem at one point only, namely, the cost of short-term finance or working capital, ignoring the equally important aspects of technique and efficiency of production and the technique and efficiency of marketing. Moreover, there was a tendency to overlook the simple fact that the knowledge and character of a small social unit is rarely much above the knowledge and character of the individuals composing it, while the needs of mass action particularly in the peculiar social structure of India are apt to bring to the surface evil proclivities from which the individual acting for himself is happily free. In the result, co-operation has been moving along a trail of bad management, factitious or communal policies, collusion, accumulated overdues, etc.†

It is clear that in the present state of our agriculture, there cannot be a direct contact between commercial banks and the individual cultivator. Some intermediaries like central co-operative banks and co-operative societies are quite unavoidable. Efforts must be largely concentrated

		1936-37
* No. of Societies in India		76,000
No. of Members		22,00,000
Members as percentage of agricultural population		5%
Working Capital	Crores	27
Share Capital and Reserves British India	,,	8

† See Table 4 Bulletin No. 8. Reserve Bank of India (Agricultural Credit Department.)

on the one hand on reducing the number and cost of such mediate links and on the other hand on making the primary society an effective instrument for converting agriculture into a solvent and profitable business and the agriculturist into a keen and dependable businessman. It is obvious that the latter task is both more vital and difficult.

Most of the proposals made with the latter objective in view suffer from one grave drawback. They tend to look on the ryot as a perpetual infant who has to be put under the guardianship of a multi-purpose society which leaves him no discretion on any side of his economic life. Some of these proposals seek to save him from the temptation of cash which is not to be allowed to fall into his hands. Others aim at taking into custody his annual produce and allowing only net profits to reach his hands. Others go so far as to eliminate cash altogether and arrange all settlements to take place in kind. While many of their incidental proposals deserve adoption as interim or transitional palliatives, it would be a grave error to permit education and mental upliftment of the ryot to fall into the background in preference for such illusory shortcuts.*

Despite the keen competition of co-operative societies and despite the heavy losses and difficulties of the last depression, the money-lender and the indigenous banker still continue to be the backbone of our rural finance.† Recent country-wide legislation on money-lending and old indebtedness may lead, more by the implied threat than any actual enforcement, to an improvement in their practices and methods of business. But it is hardly conceivable that their partnership in agriculture itself will diminish in importance. It deserves to be considered very carefully how far these ancient agencies could be made into serviceable links between agriculture and commercial banks.

Not all money lenders and indigenous bankers will be

* Bulletins Nos. 1, 2, 3 and 5. Reserve Bank of India. (Agriculture Credit Department.)

† 1931. Number of Money-Lenders.

Bengal	85,000	
Bombay	20,000	
C. P.	48,000	Bank-managers-Money-
B and O	100,000	lenders and their employees.
Delhi	100	All-India—329, 500.
Ajmir-Merwara ...	17	
N. W. F. P.	657	Paying Income-tax in 1938-39

found useful for this purpose. For obvious reasons, those who are principally agriculturists, merchants or traders will have to be excluded from such schemes. Of the others, only such could be deemed eligible as agree to follow strict banking practices, to maintain their accounts in certain prescribed forms and exhibit their financial position from time to time as required. It would be also necessary to devise a special form of bill or pro-note against which commercial banks and, in case of need, the Reserve Bank might advance funds. Perhaps, the village as a whole or those of the village community who are agreeable to maintain exclusive relations with these authorised agencies might be made joint and several parties to the document. Since commercial banks are expected to advance funds in the first instance, they must be invited to share in the selection of the agencies, along with the Reserve Bank. If the scheme succeeds, money lending could be made at a later stage a profession on a licensed basis.

Since close contact with rural financial agency and rural borrowers is the only safe basis for rural credit, it is desirable that only those banks which are highly localised in their operations should engage in this field. Most of the smaller banks answer well to this description. Among the bigger banks, the Punjab National Bank, the Allahabad Bank, the Bank of Baroda, the Indian Bank of Madras and the Bank of Mysore are well situated to take the lead in this matter in their respective areas of operation. Co-operation between these banks and the provincial co-operative banks which have the undoubted leadership of co-operative credit societies should solve many of the problems which have proved intractable till now. The foundations for such co-operation have been well laid by the creation of the Reserve Bank of India which has been invested with special responsibilities for agricultural credit and its improvement. These special responsibilities which are analysed and discussed in another place* will indicate the great part which the Reserve Bank is expected to play in the reconstruction of our rural financial economy.

* Pp. 280-88.

TABLE XIII The Big Five, Aggregated Balance-sheets. (See note to table XIV)
(In lakhs)

	Capital and Reserve.	Fixed Deposits.	Current Deposits.	Corresponding & (total) Deposits	Loans, Advances, Bills.	Investments.	Cash.
1910 ...	118	......	......	......	......	......	......
1911 ...	123	......	......	......	......	......	......
1912 ...	154	350 ×	135	485 (1217)	546 (Ex-Allahabad)	......	82 (Ex-Allahabad)
1913 ...	164	929 †	140	1069 (928)	876 (Ex-Baroda)	......	225 (Ex-Baroda)
1914 ...	181	692 ‡	198	890 (921)	812	......	252
1915 ...	186	650 ‡	261	711 (962)	811	......	207
1916 ...	190	765 ‡	375	1140 (1286)	993	......	325
1917 ...	204	839 §	416	755 (1711)	1254	......	547
1918 ...	267	871 °	478	1349 ...	1833 (Ex-Punjab)	......	488 (Ex-Punjab)
1919 ...	350	1446 ‡	881	2327 (3248)	2286	......	682
1920 ...	......	1576 °	841	2417	2483 (Ex-Punjab)	424 (Ex-Punjab)	745 (Ex-Punjab)
1921 ...	......	1529 $	1332	2861	2051 (Ex-Punjab and Allahabad)	447 („)	483 („)
1922 ...	......	2388 $	1463	3851	2590 (Ex-Punjab)	701 („)	680 („)
1923 ...	......	2462 $	1686	4148	2850 („)	1191 („)	849 („)
1924 ...	616	2764 *	1526	4290 (Total)	2924	1393	935
1925 ...	629	2902	1685	4587 „	2922	1543	934
1926 ...	632	3078	1681	4759 „	2926	2051	751
1927 ...	682	3119	1748	1867 „	3060	2207	623
1928 ...	628	3191	1671	4862 „	3190	1999	677
1929 ...	628	2997	1612	4609 „	2850	1790	620
1930 ...	628	3096	1942	5083 „	2520	1794	672
1931 ...	611	3207	1781	4988 „	2279	1840	607
1932 ...	622	3204	2469	5673 „	2070	2081	697
1933 ...	620	3286	2458	5744 „	2133	2656	857
1934 ...	621	3276	2760	6036 „	2676	2664	653
1935 ...	624	3320	3200	6520 „	2790	2407	706
1936 ...	626	3504	3519	7023 „	3090	2812	1117
1937 ...	637	3466	3536	7002 „	3539	2650	1157
1938 ...	647	3764	3529	7293 „	3529	2764	1033
1939							
1940							

Figures of fixed Current are subject to the foot-notes following.

× India, Punjab and Central only.
† India, Punjab, Central and Allahabad.
‡ 1914-16 India, Allahabad, Punjab, Baroda.
§ India, Punjab, Baroda.
° India, Allahabad, Baroda.
$ India, Central, Baroda.
* All Five for subsequent years.

TABLE XIV. Percentages to Deposits of Big Five

(In this table the percentages calculated on the basis of figures of Big Five have been so indicated. In the case of other percentages, the Big Five and the Indian and Mysore Banks figures have been used where ever the required returns are made. The agreement between the totals of the subhead percentages and the percentages for main heads of the Big Five dirctly derived indicate that the subhead figures represent fairly well the figures for the Big Five.)

	Capital and Reserves. Big Five.	Fixed & Savings Deposits to total Deposits.	Cash credits and Demand-Advances.	Loans.	Bills Discounted.	3+4+5.	Loans, Advances, Bills Big Five.	Cash Big Five.	Government Securities.	Improvement Port Trust and Mnpal. Bonds.	Debentures, ordinary preference Shares.	Total Investments 9+10+11.	Total Investmental Big Five	Capital & Reserves to Deposits. Indian Jt.-Stock Banks: Class A. 1890=18.8 1900=15.7 1906=16.4 1910=10.7	Class B
1912 ...	12.8	72.1‡	27.6†	49.8†	18.0*	95.4	96.1	14.4	10.7	...	...	10.7	18.6	15.6	...
1913 ...	17.8	86.9§	35.9*	30.5*	17.2‡	83.6	81.8	21.0	5.7	...	...	5.7	7.3	16.1	33.1
1914 ...	19.6	77.1*	35.0	39.1	14.7	88.8	88 1	27.3	5.3	...	...	5.3	8.3	22.9	43.6
1915 ...	19.3	91.4	34.7	33.0	14.7	82.4	84.3	21.5	6.0	...	...	6.0	8.4	24.5	...
1916 ...	14.8	67.1	34.9	25.5	12.1	72.5	77.2	25.2	6.3	...	...	6.3	7.5	18.6	...
1917 ...	11.9	44.9†	28.8	25.4	15.3	79.5	73.2	31.9	10.6	...	...	10.6	8.3	...	...
1918 ...	...	64.5§	33.1‡	27.8‡	8.1†	69.0	76.6	28.0	12.1	...	...	12.1	11.9	...	...
1919 ...	10.6	62.1*	36.5	22.6	9.1	68.9	69.6	20.7	18.7	...	...	18.7	19.2	12.9	...
1920 ...	...	65.2§	33.0	27.5	10.1	70.6	70.7	21.2	11.9	...	...	11.9	12.0	15.3	34.7
1921 ...	...	53.4‡	27.1§	35.1§	9.5	71.7	71 6	16.8	15.2	...	...	15.2	15.6	16.1	...
1922 ...	...	62.1	32.1‡	28.0‡	6.5	66.6	66.9	17.6	14.1	...	...	14.1	18.2?	17.2	...
1923 ...	...	59.3	29.2§	28.7§	9.1	67.0	68.7	20.4	22.0	...	...	22.0	28.7?	...	...
1924 ...	14.3	64.4‖	26.1	29.7	8.9	64.7	68.1	21.7	25.4	...	2.0	27.4	32.4?	...	...
1925 ...	13.7	63.2	24.8	29.8	7.0	61.6	63.7	20.3	32.7	...	2.2	34.9	33.6	...	...
1926 ...	13.2	64.6	27.6	27.4	7.2	62.2	61.4	15.7	37.7	4.0	3.7	45.4	43.1	...	...
1927 ...	12.9	64.0	31.9	23.5	7.8	63.2	62.8	12.8	35.1	4.6	3.4	43.1	45.3	...	...
1928 ...	12.9	65.6	31.8‖	24.8‖	7.1	63.7	65.6	13.9	34.8	4.4	3.4	42.6	45.3	...	...
1929 ...	13.6	65.0	32.4	23.7	6.6	62.7	61.8	13.4	31.7	5.1	4.6	41.3	38.8	...	...
1930 ...	12.4	61.4	26.6	21.8	3.3	51.7	50.0	13.3	29.8	4.4	3.4	37.6	35.6	18.7	32.1
1931 ...	12.2	64.2	23.7	19.4	3.0	46.1	45.6	12.1	31.3	4.5	3.4	39.2	36.8	...	...
1932 ...	10.9	56.4	19.6	17.8	1.8	39.2	36.5	12.2	31.6	4.6	4.2	40.4	36.7	...	...
1933 ...	10.8	57.2	22.8	16.1	1.5	40.4	37.1	14.9	40.4	6.2	2.9	49.5	46.2	...	...
1934 ...	10.2	54.2	26.9	20.3	2.4	49.6	44.3	10.8	37.3	5.7	3.6	46.6	44.1	16.5	29.1
1935 ...	9.5	50.9	33.8	19.0	2.0	54.8	42.7	10.8	30.5	4.6	4.0	39.1	36.9	...	...
1936 ...	8.9	49.8	26.1	19.5	2.9	48.5	43.9	15.9	32.6	5.3	3.4	41.3	40.0	14.2	28.2
1937 ...	9.1	49.5	34.7	16.5	3.6	54.8	50.5	16.5	29.6	5.0	5.4	40.0	37.2	...	...
1938 ...	8.8	51.6	33.5	16.5	3.2	53.2	48.9	14.3	30.2	4.7	5.5	40.4	38.4	...	...

Column 2. ‡ India, Punjab, Central. § Previous 3. † Allahabad. * 1914-16—India, Punjab Baroda, Allahabad. * India, Allahabad, Baroda, ‖ All Five onwards.

Columns 3 and 4. India, Central. † 1913-17—India Allahabad, Central. * 1918-20 and 1923-27. India, Allahabad, Central Baroda. ‡ India, Central. Baroda. § India, Allahabad, Baroda. ‡ 1928 onwards—India, Allahabad, Baroda, Mysore.

Column 5. India, Central, Baroda. * 1913-17—India, Central, Allahabad, Mysore. ‡ 1918 onwards—India, Central, Allahabad, Baroda Mysore. except 1921 Allahabad, 1920-21 Mysore omitted. 1930-34 Baroda omitted.

Columns 7-8. 1918-20, 1922-23 Punjab omitted. 1912 Allahabad omitted. 1921 Allahabad and Punjab omitted.

CHAPTER VI.

THE LEADING INDIAN JOINT-STOCK BANKS

Bank of India

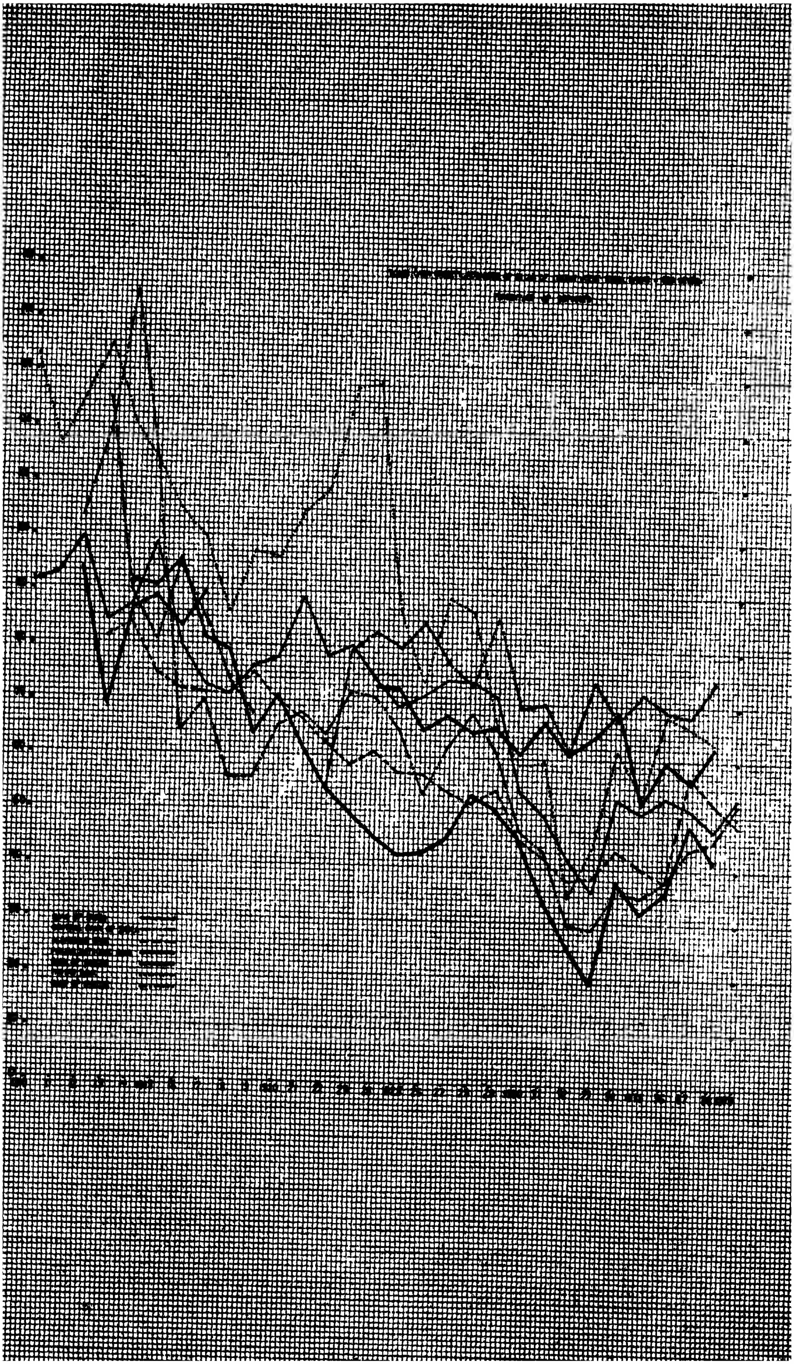
THE BANK of India was registered in 1906 in the memorable days of the Swadeshi movement and started operations in the same year. With a capital of 50 lakhs and total liabilities in December 1906, of 66 lakhs only, it made quick strides till in 1912, the eve of the banking crisis, its capital, reserve and liabilities exceeded 3 crores. In 1920, the liabilities amounted to well above 11 crores and in 1938, they exceeded 19 crores, composed of 1 crore capital, a reserve of more than 1 crore and deposits of 17 crores and odd. In point of resources, the bank held in 1938 the second place among the Big Five.*

Among Indian joint-stock banks, the Bank of India has enjoyed a remarkable immunity from runs. In 1910, "most alarming rumours" were in circulation about the losses of the Bank in the failure of Dwarkadas Dharamsey. In 1913, the directors were able to report that not a rupee was lost on that account. It was stated at the general Meeting of February 1914 that even in the great banking crisis which preceded, the Bank was "no more than slightly affected."

One effect of 1913-14 crisis was that the Bank created "with regret" a reserve fund for bad and doubtful debts.

The Bank has pursued a very cautious policy of expansion. Till 1927 when its capital, reserve and deposit liabilities exceeded 5 crores, it had no branch. By 1938, its branches numbered only 16 of which as many as 6 were in Bombay and 8 in the big urban and industrial centres of Ahmedabad, Poona, Nagpur and Calcutta. The bank is thus entirely a bank for cities with average resources per branch of 120 lakhs and more.

* For all figures, refer to Tables XV and XVI and in case of "Working—Profit and Loss' to Tables XXXIII & XXXIV.



It showed some venture in opening a branch outside India at Mombasa in 1921. Unfortunately, a collapse of credit was reported from Africa by December 1922 the effects of which were aggravated by the behaviour of the Bank's agent. It was found that he had concealed facts and made advances against express instructions of the head office. After an inquiry by the Bank's auditors deputed from India, the branch came to an end by 1923.

The Bank has sought to maintain an impressively large ratio of capital and reserve to its deposit liabilities. Till inflation became serious during the Great War, the ratio was well above 20 per cent. When in the course of war-inflation, deposits expanded rapidly and the ratio fell seriously, steps were taken in 1919 to double the capital and to add materially to the reserve. Till the onset of the Depression, the ratio continued well above 15 per cent. The Depression caused no slackening in the growth of deposits and the ratio fell to about 12 per cent. With abundance of funds and slack demand, this fall does not mean any weakening of the creditors' guarantee.

Among assets, loans and advances amounted to 65 per cent. and more of deposits till Depression set in. The Bank also held a strong portfolio of bills which tended to be more than 10 per cent. of deposits. The Depression caused a shrinkage in loans and advances which reached as low a level as 40 per cent. There was a subsequent recovery to 50 per cent. The quantity of bills suffered much more amounting to less than 1 per cent. of deposits in post 1929 years.

It is noteworthy that for a few years after the Bank was started, its constitution prohibited advances against shares and on mortgage. Experience showed that this prohibition was a great hindrance to the full employment of the Bank's funds. In 1911, the rules were altered so as to permit such advances. As the war broke out only three years later, the relaxation proved very timely and the Bank was able to raise its loans and advances progressively to as high levels as 80 and 85 per cent. in 1914 and 1915.

The bulk of the Bank's investments is in government securities. Debentures, preference and ordinary shares of joint stock companies have never been above 2 per cent. of deposits and even Improvement Trust, Port Trust and cent. Investments are, as we have already noted, the Municipal Bonds are not allowed to rise above 6 or 7 per means par excellence of adaptation to cyclical and secular changes. About 10 per cent. of deposits before the Great War, they fell very low during the War and then increased after 1922 till during the Depression a level above 30 per cent. was reached.

Except during the crisis of 1913-14 and the War years, when it reached levels above 25 and 30 per cent., the cash ratio of the Bank has been maintained between 15 and 20 per cent.

The Bank of India is one of the few fortunate Indian banks which have escaped the activities of professional "credit wreckers" in the country. The only serious incident* in its steady and undisturbed career was a temporary three days' spell of unpopularity in 1930 which took shape more as a political demonstration than a run and was speedily proved to be the outcome of sheer misapprehension. The rumour originated in the Bombay Stock Exchange and as the bank acts as the clearing house for the Exchange, the members and hangers-on of that institution took a prominent part in the incident.

As pointed out above, the bank is remarkable for three features, the fewness of its branches, its concentration in a few, big urban and industrial centres of the country and its high degree of liquidity which perhaps is largely a product of the first two features. These facts are well reflected in its rate of gross profits which is lower than that of any other bank with the exception of the Bank of Baroda. Since its deposits are certainly not raised at higher rates

* 21st May 1930. An allegation was made at the General Meeting of the Bombay Stock Exchange that the British Manager of the Bank had taken part in the suppression of the Civil Disobedience movement in the country. In spite of an emphatic denial by the Manager communicated immediately through a responsible person, the members persisted in the allegation and helped to spread it. The outcome was an angry crowd at the Bank.

than those of other banks, this low rate of gross profits is only indicative of the very liquid and safe business it engages in and the low rates which are realisable on such business. Unlike many other banks, the rate of gross profits of the Bank of India seems to have stabilised itself round about 2 per cent. It has rarely fallen below 1·90 per cent.—its lowest level being 1·47 per cent. during the last Depression.

Its expense ratio is easily the best among all Indian banks, which bespeaks the large volume of business available in a few big cities in the country. Till 1925, it paid less than 20 per cent. of its gross profits in salaries but the fraction has since then mounted to round about 25 per cent. With a volume of resources per branch which is about four times what the bank next in rank *viz.* the Central Bank of India can claim, it is not surprising that its expense per unit of resources handled should be the lowest on record.

Its rate of net profits is as a rule second only to that of the Imperial Bank of India. It started with a dividend of 5 per cent. in 1907, raised it to 8 per cent. about the time of the Great War and in the twenties and thereafter has maintained it at 10 to 12 per cent. Even in 1907, its half-paid shares of Rs. 100 nominal value stood between Rs. 53 to 66½ and have continually appreciated since. In 1916, Indian Banks were quoted at 62-68 and by 1929, at Rs. 97 to 105. The lowest level of the Depression period was Rs. 72¾ to 90 in 1931 but by 1936, they mounted once more to Rs. 125½ to 142. The history of its reserves proves that this value has not been inflated or maintained by imprudent or fictitious dividends. It had paid usually 2/3rds of its net profits in dividends—which is certainly a conservative procedure.

TABLE XV.

Bank of India. (Dec. 31st. Figures in lakhs.)

	Paid-up Capital.	Reserves.	Total 1+2.	Fixed and Savings Deposits.	Current Deposits.	Total Deposits 4+5.	Total Liabilities 3+6.	Cash Credits & Demand Advances.	Loans.	Bills Discounted and purchased.	Landed Property at or below cost.	Government Security.	I. T., P. T. & Municipal Bonds.	Jt-Stock Co. Debentures, Preference & ordinary shares.	Total Investment at or below mkt. value 12+13+14	Treasury Bills at Par.	Cash in hand or at Bank.	Gross Profits 000s.	Net Profits 000s.	Salaries 000s.	Rest. 000s.
1906	48	...	48	14	4	18	66	6	4	48	...	...	...	...	...	...	7	38	25	6	5
1907	50	...	50	79	39	118	168	25	36	70	...	...	...	...	15	...	22	443	328	68	27
1908	50	0.5	50.5	84	79	153	203	33	79	53	...	...	...	...	23	...	29	586	451	79	36
1909	50	1.7	51.7	135	80	215	266	46	106	54	...	14	...	...	24	...	39	571	422	87	32
1910	50	1.7	51.7	168	94	262	313	44	121	75	...	43	...	...	43	...	34	555	388	96	30
1911	50	3.0	53.0	151	120	271	324	38	150	64	...	26	...	...	28	...	46	486	317	100	27
1912	50	3.0	53.0	162	90	252	305	53	124	74	5 (incl. investment)	18	...	...	23	...	34	600	422	108	34
1913	50	5.0	56.0	157	65	222	277	69	94	24	7 ,,	22	...	...	22	...	63	666	475	114	36
1914	50	5.0	55.0	115	85	200	255	61	102	13	4	...	...	...	7	...	71	561	351	126	42
1915	50	5.0	55	106	104	210	265	78	102	27	4	...	...	...	20	...	37	639	447	115	40
1916	50	7.0	57	180	163	343	400	137	100	40	3	...	...	...	24	...	95	963	721	127	74
1917	50	10.0	60	152	317	479	539	130	158	62	3	...	...	...	37	...	145	1069	721	150	132
1918	50	12.0	62	202	279	481	543	189	145	35	0.9	...	...	...	62	...	119	1302	784	172	280
1919	99	64.0	163	281	457	738	901	280	199	88	0.9	...	...	...	161 (incl. T.Bs.)	—	181	1500	1028	220	153
1920	100	66.0	166	512	454	966	1132	327	318	112	2.4	...	...	...	134 ,,	50	252	3311	2758	323	103
1921	100	77.0	170	515	536	1051	1221	388	404	142	3.4	...	...	...	135 ,,	40	160	2793	2058	438	148
1922	100	72.0	172	538	463	1001	1173	331	396	61	5.0	...	...	...	207 ,,	82	185	3058	2173	552	148
1923	100	72.0	172	505	462	967	1139	279	426	83	4.9	...	...	...	166 ,,	3	197	2617	1922	453	114
1924	100	74.0	174	523	427	950	1124	206	395	109	6.2	182	...	13	195	...	229	2741	2000	483	121
1925	100	76.0	176	522	497	1019	1195	214	439	60	6.8	222	13	12	248	...	242	2330	1541	492	156
1926	100	78.0	178	525	463	988	1166	257	403	48	12.6	242	54	12	309	...	146	2052	1256	512	144
1927	100	79.0	179	666	364	1030	1209	352	376	43	11.8	228	60	12	300	...	150	2557	1654	572	172
1928	100	82.0	182	724	382	1106	1288	394	377	43	9.5	229	72	12	314	...	175	2917	1908	568	196
1929	100	86.0	186	675	442	1117	1303	384	352	64	7.3	252	65	12	329	...	192	2940	1872	627	200
1930	100	90.0	190	751	538	1289	1479	364	335	6	11.7	214	62	11	288	287	214	2742	1598	698	238
1931	100	92.0	192	816	478	1294	1486	311	331	6	10.7	201	58	11	273	341	225	3210	1977	738	229
1932	100	100.0	200	817	690	1507	1707	308	319	4	9.7	317	72	8	398	454	221	2521	1235	787	264
1933	100	100.0	200	838	611	1449	1649	312	263	4	11.3	450	99	10	560	265	244	2724	1352	825	289
1934	100	100.0	200	791	674	1465	1665	404	357	22	10.2	367	100	10	478	248	166	3212	1764	845	264
1935	100	102.0	202	772	844	1616	1818	452	358	11	10.8	374	99	10	484	300	219	3427	1862	904	293
1936	100	104.0	204	805	894	1699	1903	483	407	17	11.0	434	96	13	545	216	241	3624	2063	951	287
1937	100	105.0	205	778	935	1713	1918	500	357	34	9.1	431	91	13	537	156	343	3766	2162	994	296
1938	100	108.0	208	828	896	1724	1932	467	328	25	5.5	441	75	14	513	292	300	3892	2181	1051	320
1939	100	110.0	210	817	1042	1859	2079	573	380	43	14.9	398	79	14	491	214	378	4123	2170	1109	...

TABLE XVI Bank of India, Percentage to Deposits (Dec. 31st)

	Paid-up Capital and Reserve.	Fixed and Savings Deposits to total Deposits.	Current Deposits to total Deposits	Cash Credits and Demand Advances.	Loans.	Bills Discounted and Purchased	Landed Property at or below cost.	Government Security.	Improvement Trust, Port Trust Municipal Bonds.	Joint-Stock to Debentures Preference and Ordinary Shares.	Total Investment at or below Market value 8+9+10.	Treasury Bills at Par.	Cash in hand at Bank.
1906	266	77.7		33.3	22.2	266		...	...	...	...	...	38.8
1907	42	66.9		21.1	30.5	59.8		...	...	...	12.7	...	18.6
1908	33	54.9		21.5	51.6	34.6		...	...	...	15.0	...	18.9
1909	24	62.7		21.3	49.3	25.1		6.5	...	...	11.1	...	18.1
1910	19	64.1		16.7	46.1	28.6		16.4	...	...	16.4	...	12.9
1911	19	55.7		14.0	55.3	23.6		9.5	...	...	10.3	...	16.9
1912	21	64.2		21.0	49.2	29.3		7.1	...	...	9.1	...	18.4
1913	24	70.7		31.0	42.3	10.8		9.9	...	...	9.9	...	28.8
1914	27	57.5		30.5	50.5	6.5		...	...	...	8.5	...	35.5
1915	26	50.4		37.1	48.5	12.8		...	...	...	9.5	...	17.6
1916	16	52.4		39.9	29.1	11.6		...	...	...	6.9	...	27.6
1917	12	31.7		27.1	32.9	12.9		...	...	...	7.7	...	30.2
1918	12.8	41.9		39.2	30.1	7.2		...	...	...	12.8	...	24.7
1919	22.0	38.0		37.9	26.9	11.9		...	...	...	21.8 (incl. T.Bs.)	...	24.5
1920	17.1	53.0		33.8	32.9	11.5		...	...	...	8.6	5.1	26.0
1921	16.1	49.0		36.9	38.4	13.5		...	...	...	9.0	3.8	15.2
1922	17.1	53.7		33.0	39.5	6.0		...	...	...	12.4	8.1	18.4
1923	17.7	52.2		28.8	44.0	8.5		...	...	...	16.8	0.3	20.3
1924	18.3	55.0		21.6	41.5	11.4		19.1	...	1.3	20.4	...	24.1
1925	17.2	51.2		21.0	43.0	5.8		21.7	1.2	1.1	24.0	...	23.7
1926	18.0	53.1		26.0	40.7	4.8		24.5	5.4	1.2	31.1	...	14.7
1927	17.8	64.6		34.1	36.5	4.1		22.1	5.8	1.1	29.6	...	14.5
1927	16.4	65.4		35.6	34.0	3.8		20.7	6.5	1.0	28.0	...	15.8
1929	16.6	60.4		34.3	31.5	5.7		22.5	5.8	1.0	29.3	...	17.1
1930	14.7	58.2		28.2	25.9	0.5		16.6	4.8	0.8	22.2	22.7	14.4
1931	14.8	63.0		24.0	25.5	0.4		15.5	4.4	0.8	20.7	26.3	17.5
1932	18.2	54.2		20.4	21.1	0.2		21.0	4.7	0.5	26.2	30.1	15.0
1933	13.8	57.8		21.5	18.1	0.3		31.0	6.8	0.6	38.4	18.2	16.8
1934	13.6	53.9		27.5	24.3	1.5		25.0	6.8	0.6	32.4	16.9	11.3
1935	12.5	47.7		27.9	22.1	0.6		23.1	6.1	0.6	29.8	18.5	13.5
1936	12.0	47.3		28.4	23.9	1.0		25.5	5.6	0.7	31.8	12.7	14.1
1937	11.9	45.4		29.1	20.8	1.9		25.1	5.3	0.7	31.1	9.1	20.0
1938	12.0	48.0		27.0	10.0	1.4		25.1	4.3	0.8	30.6	16.9	17.4
1939	11.3	43.7		30.8	20.4	2.3		21.4	4.2	0.7	26.3	11.8	20.0
1940													

Central Bank of India*

The Central Bank of India was launched into existence in December 1911 mainly by the untiring efforts and banking genius of Sorabji Pochkhanwalla whose life history belongs to the regions of romance in banking and finance. In Sir Phirozeshah Mehta, the Bank secured a chairman who brought with him great public prestige and patriotic appeal. In spite of difficult situations, the bank made astonishingly rapid progress and passed all other joint-stock banks in the size of its aggregate resources. Its capital, reserve and deposits, amounting to a mere 77 lakhs in December 1912, reached more than 10 crores in December 1920, about 15 crores in 1930 and 31 crores in 1938.

The year 1923 which saw the amalgamation of the Tata Industrial Bank with it was a turning point in the bank's career.† Two shares of the Tata Industrial Bank, each of the nominal value of Rs. 75 and paid-up value of Rs. 22-8 were exchanged for one Central Bank share of nominal value Rs. 50 and paid-up value Rs. 25. The shareholders of the Tata Bank lost by the exchange Rs. 5 only since the Central Bank shares were being then quoted at Rs. 40. They even gained something since the uncalled liability of Rs. 105 on two Tata shares was now converted into an uncalled liability of Rs. 25 only on one Central Bank share. The aforesaid difference of Rs. 5 was taken as writing off the losses of the Tata Bank.

The effect of the amalgamation of the balance-sheet of the new Central Bank was profound. The capital and reserve liability which stood at Rs. 80 lakhs in December 1922 rose to Rs. 268 lakhs in December 1923. The deposits rose from Rs. 14 crores to Rs. 18 crores. The ratio of capital and reserve to deposits which had sunk during the War and post-War years to as low as 5 to 7 per cent. now improved to 17 to 18 per cent.

More far-reaching was the effect on the quality and distribution of the assets. The ratio of loans and advances

* Tables XVII and XVIII & Tables XXXIII & XXXIV.

† Pp. 299-300.

to deposits did not alter much—it increased for a short time only from 55 per cent. to about 60 per cent. But investments which were rarely above 20 per cent. in previous years shot up to 44 and 53 per cent. in the next two years. The change in their quality was equally remarkable.* The cash ratio remained very much the same except for the panic year 1924. The balance-sheet has never lost its mark of the great amalgamation. Unlike the Bank of India, the Central Bank has pursued a very vigorous policy of branch expansion. It opened its first branch at Karachi in the early phase of the Great War but at its close, the number of branches was still 5 only. By 1934, it had created 68 branches and pay-offices which mounted up to 89 in 1937 and 101 in 1938. Comparing the branches and pay-offices to its aggregate resources, the bank has about 33 lakhs per office.

Few Indian joint-stock banks have faced more difficulties. It has been recorded that there were as many as 9 runs on the bank during the first 25 years of its existence.

Almost at its very birth, it became involved in the banking crisis of 1913-14. Grossly exaggerated reports about its holdings of or loans against the shares of the Indian Specie Bank found eager circulation. In the last few months of 1913, the young bank paid out as much as 75 lakhs before the run abated.

In 1918 again, the bank suffered from two successive panics caused by the collapse of certain markets in the Bombay City.

The absorption of the Tata Bank gave another opportunity to the enemies of the bank. Certain shareholders started frivolous legal proceedings against it. The consequence was an "organised run" on the Calcutta branch during which the bank paid out Rs. 50 lakhs. During the silver jubilee proceedings of the next year, the Managing Director was constrained to complain of "the despicable habit of irresponsible persons of making reckless and unfounded charges and instituting futile legal pro-

* P. 156.

ceedings." The matter had by now assumed grave proportions and all responsible sections of the community and the Press in the country joined the Managing Director in deprecating and reprimanding these activities.

Hardly had the voice of admonition died down when another "organised attempt to impair its credit" became visible. In the course of two brief days in August 1925, the bank stood a run of 2 crores and more.*

After surviving the crisis of 1913-14, the bank found itself confronted with conditions of war. In spite of doubling the paid-up capital and making some addition to the reserve, the ratio to deposits fell to less than 7 per cent. The real recovery in the ratio of capital and reserve to deposits occurred, as recorded above, with the amalgamation. From that year till the onset of the Depression the ratio was well above 15 per cent. The Depression coincided among other forces with a great expansion of branches. Between 1930 and 1938, deposits practically doubled and the ratio fell continuously to 8 per cent. The bank may well be awaiting a favourable opportunity in the capital market to strengthen the fixed capital structure of the bank.

Till the Depression, the bank aimed at a level of loans and advances somewhere in the neighbourhood of 55 per cent. of deposits. Its bill portfolio fluctuated a good deal, tending to be about 10 per cent. of deposits.

With the amalgamation of 1923, the proportion of investments rose very sharply from about 20 to 25 per cent. of deposits in pre-1923 years to more than 50 to 60 per cent. The steep fall in loans and advances after 1930—from a level of 55 per cent. to 35 per cent. and less, confirmed the importance of investments still further although there was a little fall subsequently. Government and "other" gilt-

* This run had a curious origin. Some merchants lost heavily in sugar and wool. Among them, one bore the name of Ajam which was also the name of one of the directors of the Central Bank. On this flimsy basis, the usual detractors of the bank are said to have created a scare in the Zaveri bazzar in Bombay. Despite categorical denials, the panic was reproduced at Ahmedabad

Commerce—September 5th 1925.

The last run, which however was on a small scale, occurred on 15th July 1939 when baseless rumours were circulated that the bank had incurred losses on account of the fall of silver prices.

edged securities form the backbone of Investments, being more than 1/2 and even 3/4ths sometimes of the total. In post-Depression years, ordinary and preference shares of joint-stock companies recorded a marked improvement from less than 2 per cent. to more than 5 to 6 per cent. of deposits.

Lands and Buildings and investment in Lands and Buildings have always claimed a sizable share of the bank's funds. The amalgamation brought with it the splendid structure of the Tata Industrial Bank and raised the bank's investments in property to more than 5 per cent. of deposits. Despite the doubling of deposits between 1930 and 1938, the proportion of funds invested in property is still returned at about 4 per cent. This 4 per cent. in property and 6 per cent. locked up in ordinary shares, of companies represent the bank's most fluctuating asset. In value, they amount to 3 crores and more.

In the lean years after the crisis, treasury bills were for sometime an excellent outlet for accumulating funds. For the rest, the bank's cash ratio has been of a very unstable character. Between 15 to 20 per cent. generally before the amalgamation, it showed a tendency to fall subsequently to less than 12 per cent. But the stagnation of 1932 and 1933 raised it immediately to more than 15 per cent. and in 1935, it actually shot up to 32 per cent. and more.

The Central Bank of India shares the honour with the Imperial Bank of being represented in all the provinces and advanced parts of India. The average rate of interest offered by it on time and demand deposits taken together is lower than what is paid by the Allahabad and Punjab National banks which have their areas of operation concentrated in the Punjab and the U. P. It is of course much lower than the rate of the Indian Bank of South India. Till 1920, the average fell generally between 2·0 and 3·5 per cent. and in the succeeding twenties of high interest rates all over the world, it moved between 3·6 and 4·3 per

cent. After the Depression, the rate fell steeply from 3·23 in 1930 to a mere 1·3 per cent. in 1938.

The rates for the Central Bank on the one hand and of Allahabad, Punjab National and Indian banks on the other show differences ranging between ·6 per cent. to 1·5 per cent. The margins are even wider for certain exceptional years.

From 1921, the Central Bank instituted the most instructive and valuable practice of giving under separate heads the aggregate interest paid on fixed deposits and current deposits. The average rate on current deposits in the twenties ranged between 2·1 to 2·5 per cent. After 1931, it began to fall till the unexampled low levels of ·81 and ·77 were recorded for 1937 and 1938.

More important still is the margin which the bank has found necessary to maintain between fixed and current deposit rates. In the twenties, fixed rates were above current rates by more than 2 to 3 per cent. The margin narrowed only after 1934 since when it has been between 1·3 to 2 per cent.

To appreciate the significance of these rates for the working of the bank and its profits in particular, we must recall here that the Central Bank's current and savings accounts have been generally slightly less than 50 per cent. of total deposits in the twenties and have grown to 55 to 60 per cent. in recent years. This ratio is no doubt more favourable to the Central Bank than to the other banks we have just now mentioned. Even then, the rate paid on current and savings account is sufficiently high to make it a very important factor in the bank's investment policies.

In industrial and urban India, competition is very keen. The average rate of earning per cent which represents the minimum above which the rates charged to customers must range prove these disparities of conditions. While earnings

above 6 and 7 per cent. are most common for the Punjab National and Allahabad banks and 8 to 9 per cent. is the earning rate of the Indian bank in the South, the rate of the Central Bank falls usually between 6 to 7 per cent. Of course, some allowance may have to be made for differences in the quality of business sought.

The Central Bank has paid 20 to 25 per cent. of its gross profits in salaries in the earlier years and the fraction has been generally 35 to 40 per cent. since 1925. The Imperial Bank, in spite of its higher salaries has been spending only a little more which indicates that the Central Bank suffers some drawback in the quality of its personnel or organisation. The Bank of India reflects purely city conditions and it is not surprising that its rate of gross profits should be lower and the expense ratio lower still. But the Bank of Baroda which represents largely rural conditions shows identical tendencies. Even more than salaries, overhead expenses of the Central Bank appear to cut rather severely into the gross profits of the Central Bank.

This analysis seems to find support in another very useful kind of information which the Central Bank alone among Indian joint stock banks supplies in its balance-sheets. Since 1924, the salaries paid at the headquarters have been separated from those of the upcountry branches. Between 1924 and 1938, the aggregate resources of the Bank have risen from 16½ crores to 33½ crores, and the branches have grown from 4 to 101. Yet, except for the last 3 years, which saw an addition of 33 branches, the proportion of salaries paid at the headquarters and those paid at the branches remained roughly half and half. It is permissible to surmise that outward expansion brings no economy in the utilisation of the headquarters organisation.

TABLE XVII CENTRAL BANK (Dec. 31st.)

	Paid-up Capital.	Reserve and Contingency fund.	Sinking fund, Land and Buildings	Total 1+2.	Current, call, Savings, Contingency & other A/cs.	Fixed Deposits and Cash Certificates.	Total Deposits. 5+6	Total Liabilities 4+7.	Cash in hand and at Bankers.	Money at call and short Notice and Bullion.	Deposits with other Bankers.	Treasury Bills.	Terminable Sterling and India Govt. Loans.	Non-terminable Indian Sterling and Rupee Loans.	Govt. and other Gilt-edged Securities.	Rupee and Sterling Joint-Stock Debentures.	Mostly, fully paid Preference and Ordinary shares of Joint-Stock Companies.	Cash. Credits and Demand Advances.	Loans.	Bills Discounted and Purchased.	Lands and Bldgs.	Investments in Land and Building	Total earnings. 000s	Interest Paid to Depositors 000s.	Interest on Fixed Deposits. 000s.	Interest on other Deposits. 000s.	Gross Profits 000s	Net Profits.	Salaries: Head quarters.	Salaries: Upcountry Branches	Miscellaneous.
1912	15	1	...	16	22	65	87	93	10	...	...	...	...		18	...	...	88	40	2	...	...	81	197	183	65	122	62	30		10
1913	15	1	...	16	6	34	40	56	5	...	...	...	...		10	...	6	22	25	0.5	...	...	787	442	348	99	295	97	44		25
1914	15	1	...	16	...	...	30	46	8	...	...	...	...		13	...	5.4	21	22	0.5	...	...	341	136	64	62	205	60	62		14
1915	15	1	...	16	...	...	50	66	6	8	...	...	...		11	...	4.1	27	19	2.3	...	...	361	194	125	69	167	77	43		21
1916	15	1	...	16	...	...	146	162	38	8	...	...	...		24.9	...	1.5	49	37	8.3	...	...	670	359	199	160	311	182	62		35
1917	25	1.6	...	26	...	...	357	383	70	11	14	...	...		...57	...	0.8	66	107	78	...	...	1374	858	493	365	516	288	102		70
1918	25	6	...	31	...	...	489	529	120	19	...	...	...		105(incl T. bls.)	...	2.7	119	139	23	...	...	2810	1040	346	694	1770	522	260		274
1919	50	14	...	64	...	...	957	1021	148	3	...	...	...		324 (,,)	...	1.2	289	206	47	...	...	4262	1516	250	1266	2746	699	443		200
1920	50	20	...	70	...	...	1093	1163	129	53	...	...	...		233 (,,)	...	1.3	316	305	99	35	...	7815	4688	3146	1542	3127	1281	713		175
1921	50	25	...	75	627	711	1338	1418	222	13	...	...	...		226 (,,)	...	3.0	358	378	184	33	...	8286	5307	3701	1606	2979	1581	1606		365
1922	50	30	...	80	594	728	1322	1402	212	8	...	...	...		285 (,,)	...	5.3	374	379	102	38	...	8884	5595	4135	1460	3289	1866	1030		427
1923	168	100	...	268	685	884	1569	1837	294	9	...	...	...		640	33	18	966		172	48	35	11039	6567	4975	1592	4472	2184	1814		552
1924	168	100	...	268	608	777	1385	1653	350	19	...	...	...		691	23	18+5.7	851		143	51	35	11647	6626	5127	1499	5021	2357	772	784	578
1925	168	100	...	268	678	742	1415	1683	290	18	...	...	...		673	24	19+1.1	782		139	54	34	10268	5860	4820	1520	4408	1891	770	799	508
1926	168	100	...	268	806	883	1689	1957	298	22	...	...	...		947	62	25	738		170	55	34	10679	6138	4884	1754	4541	1983	794	805	563
1927	168	100	...	268	758	793	1551	1819	166	3	...	...	...		1026	57	34	805		164	55	37	10512	6247	4358	1818	4265	1618	482	856	580
1928	168	100	...	268	671	772	1443	1711	140	...	...	...	...		822	49	25	866		123	55	38	9914	5747	4092	1655	4167	1552	956	877	...
1929	168	93	...	261	618	650	1263	1524	156	14	...	...	...		585	51	33	692		91		104	9132	5267	3711	1555	3865	1348	877	841	...
1930	168	36	...	254	763 +28	718	1481	1735	170	10	5	196	67	3	512	50	25	641		56		103	8893	4796	3218	1582	4097	1763	891	806	...
1931	168	70	2.7	238	788	782	1520	1758	160	10	...	404	198	1	447	42	26	609		44		111	10247	5341	4253	1786	4906	1761	874	832	...
1932	168	70	4.5	238	1134	876	2010	2248	230	15	...	567	80	2	622	52	24	576		31		110	10299	5366	4119	2247	4933	1432	894	859	...
1933	168	70	6.7	238	1223	999	2222	2460	390	11	...	221	72	38	851	59	42	636		39		111	10135	6025	3950	2075	4110	1468	918	947	...
1934	168	70	9.4	238	1356	1091	2447	2685	224	183(i b. =146)		73	86	156	796	76	105	807		73		125	10308	5129	3292	1837	5179	2384	941	990	...
1935	168	70	12.6	238	1572	1200	2700	2938	339	42,,	...	...	96	83	734	63	99	869		82		127	10711	5564	3522	2042	5147	1984	1015	1128	...
1936	168	70	15.8	238	1873	1275	3148	3386	446	25+51	113+19	119	163	96	827	65	162	1088		160		130	10997	5052	3303	1749	5945	2236	1003	1173	...
1937	168	75	19.1	243	1781	1287	3068	3311	482	0+82	28+28	7	151	68	732	105	205	1178		173		126	11841	4325	2869	1456	7516	2685	1019	1343	...
1938	168	80	21.4	248	1791	1311	3102	3350	403	6+0	50	122	183	55	785	97	208	1263		150		118	11296	4083	2889	1394	7218	2759	1018	1461	...
1939	168	87	25.3	255	1825	1161	2946	3241	400	2+26	5	...	167	49	730	82	222	1395		178		117	12278	4185	2795	1840	8136	3177	1044	1589	...

TABLE XVIII Central Bank of India. (Pecentage to Deposits.)

	Paid-up Capital and Reserve.	Fixed deposits & Cash Certificates.	Current Call Savings Contingency and other Accounts.	Cash Credits and Demand Advances.	Loans.	Bills discounted and Purchased.	Land and Bldgs.	Investments in Land and Bldgs.	Terminable Sterling and Indian Govt. Loans.	Non-terminable Indian Sterling and Rupee Loans.	Govt. and other Gilt-edged securities.	Rupee and Sterling Jt.Stock Co. Debentures.	Mostly fully paid up Preference and Ordinary shares of Jt-Stock Cos.	Investments. 9+10+11+12+13.	Treasury Bills.	Money at call or at short notice and bullion.	Deposits with other Banks.	Cash in hand and at Bank.
1912	20.1	34.3		40.3	59.9	2.6	...	...	...	23.3		...	...	23.3	...	...	...	12.9
1913	40.0	33.0		55.0	62.5	1.5	...	...	...	25.0		...	15.0	40.0	...	...	...	12.5
1914	53.3	...		70.0	73.3	1.6	...	...	...	43.3		...	18.0	61.8	...	...	...	26.6
1915	32.0	...		54.0	38.0	4.6	...	...	...	22.0		...	8.2	30.2	...	6.0	......	12.0
1916	10.9	...		33.5	25.3	5.6	...	...	...	17.0		...	1.0	18.0	...	5.4	...	26.0
1917	7.2	...		18.4	20.9	21.8	...	...	...	15.9		...	0.2	16.1	4.9	3.0	...	19.6
1918	6.2	...		23.6	27.9	4.6	...	...	...	21.0(incl T. bls.)		...	0.5	21.5	...	3.8	...	24.1
1919	6.6	...		30.1	21.5	4.9	...	...	...	33.8 ,,		...	0.1	33.9	...	0.3	...	15.4
1920	6.4	...		26.9	27.9	9.0	3.2	...	...	21.3 ,,		...	0.1	21.4	...	4.8	...	11.8
1921	5.6	53.1		26.7	28.2	13.7	2.4	...	...	16.8 ,,		...	0.2	17.0	...	0.9	...	16.5
1922	6.3	55.0		28.2	28.6	7.7	2.8	...	...	21.5 ,,		...	0.4	21.9	...	0.6	...	16.0
1923	17.0	56.3		61.4		10.9	3.0	2.2	...	40.7		2.1	1.1	43.9	...	0.6	...	18.7
1924	19.3	56.1		61.4		10.3	3.6	2.5	...	49.8		1.6	1.7	53.1	...	1.3	...	25.2
1925	18.9	52.4		55.2		9.8	3.8	2.4	...	47.5		1.6	1.4	50.5	...	1.2	...	20.4
1926	15.8	52.2		43.6		10.0	3.2	2.0	...	56.0		3.6	1.4	61.0	...	1.3	...	17.6
1927	17.2	51.1		51.9		10.5	3.5	2.3	...	66.1		3.6	2.2	71.9	...	...	...	10.7
1928	18.5	53.5		60.0		8.5	3.8	2.6	...	56.9		3.1	1.7	61.7	...	...	...	9.7
1929	20.6	51.4		54.7		7.2	8.2		...	46.8		4.0	2.6	52.9	...	1.1	0.3	12.3
1930	17.1	48.4		43.2		3.7	6.9		4.5	...	34.5	3.3	1.7	44.0	13.2	0.7	...	11.4
1931	15.6	51.4		40.6		2.8	7.8		12.9	...	29.4	2.7	1.7	44.7	26.5	0.6	...	10.5
1932	11.6	48.5		28.6		1.5	5.4		1.4	...	30.9	3.4	1.1	36.8	28.2	0.7	...	11.4
1933	10.7	44.9		28.6		1.7	4.9		3.2	1.7	33.2	2.6	1.8	47.5	9.9	0.5	...	17.5
1934	9.7	44.5		32.9		2.9	5.1		3.5	6.3	32.5	3.1	4.2	49.6	2.9	7.4	...	9.1
1935	8.8	44.4		32.1		3.0	4.7		3.5	3.0	27.1	2.3	3.6	39.5	...	1.5	...	31.1
1936	7.5	40.5		32.9		5.0	4.1		4.4	3.0	26.2	2.0	5.1	40.7	3.7	2.4	4.1	14.1
1937	7.9	41.9		33.3		5.6	4.1		4.5	2.2	23.3	3.0	6.6	40.1	0.2	0.8	1.8	15.7
1938	7.4	42.2		40.7		4.8	3.8		5.8	1.7	25.3	3.1	6.7	42.6	3.9	0.1	1.6	12.9
1939	8.5	38.9		46.7		5.9	3.6		5.6	1.6	24.4	2.7	7.2	41.6	...	0.9	0.2	13.4
1940																		

The Punjab National Bank*

The Punjab National Bank is one of the few purely Indian joint-stock banks which have survived over from the last century. It was started early in 1895 and at the year end, its paid-up capital stood at the modest figure of Rs. 41 thousand and its deposits at about 1¾ lakhs. It made very slow progress till 1905 but with the rise of the Swadeshi movement its deposits increased, exceeding Rs. 1 crore in 1910. The authorities had the prudence to raise its paid-up capital and reserve year after year till in 1910 they aggregated to about 15 lakhs.

The crisis of 1913-14 was a severe ordeal. On the outbreak of the crisis, the bank was able to call in loans very quickly and raise its holdings of cash and G. P. notes to 46 per cent. of deposits. Between September 20th of 1913 *i.e.*, the date of the collapse of the People's Bank of Lahore and 31st December, investments to the extent of 44 lakhs were realised. Its deposits fell from 147 lakhs in 1912 to 77 lakhs in 1914.

The bank set about with determination to retrieve its position. Early in 1914, 5000 more shares, each of the nominal value of Rs. 100, were issued and a further call of Rs. 10 was made on existing shares. Early in 1915 again, 1000 more shares were added to the existing mass. The paid-up capital of the bank which was about 9 lakhs in 1912 rose to 16 lakhs by 1916 and the reserve funds increased from about 8 lakhs to about 11 lakhs. By 1916 end, the deposits once more exceeded 1 crore rupees.

In the early twenties of the present century, the paid-up capital was raised above 30 lakhs and the reserves above 20 lakhs. But for an appreciable fall in the 1929-30 crisis and a few years thereafter, deposits tended to maintain themselves at a level above 7 crores.

As compared with other banks the ratio of capital and reserves to deposits has been rather modest. In exceptional years, when deposits were running low as in the early years of the bank's existence, the years following the banking crisis of 1913 and the years after the world crisis

* Tables IXX and XX.

of 1929, the ratio naturally improved. But otherwise, it used to be about 12 per cent before the Great War and in the post-war years, it has been in the neighbourhood of about 7 to 8 per cent.

Before the war, the bank's investments rarely exceeded 25 per cent. of its deposits and after 1920, they have already exceeded 35 per cent. While formerly, government securities on the one hand and government guaranteed debentures and municipal loans on the other shared about equally in the composition of investments, the post-war tendency has been to hold the bulk in the former. In recent years, a good portion of the securities has been lodged again and again with bankers against amounts due to them.*

Before the Great War, investments in "Lands, Buildings, and Machinery" rarely exceeded 2 per cent. of deposits. In post-war years, this head discloses a continuous increase, approaching the substantial fraction of 15 per cent. of deposits. It is to be presumed that most of these acquisitions have been involuntary—the property falling into the hands of the bank as security surrendered for unrealizable loans.

It is in no way strange that the last agricultural collapse should leave some trace on the position of the bank,

* (In Lakhs.)

		Due to Bankers.	Bad or Doubtful Debts.
1928	...	...	6
1929	...	41	11
1931	...	113	[illegible]
1932	...	85	...
1934	...	66	14
1935	...	28	18
1936	...	50	11
1937	...	11	8
1938	...	34	11

located as it is, in the great wheat granary of India. The balance sheet of December 1928 had returned 6 lakhs under the head "Bad and Doubtful Debts". The new auditors insisted on putting the figure in the next balance-sheet at 11·9 lakhs, "to which the directors, to be on the safe side agreed, although holding somewhat different views." This figure has remained stable,* new bad debts perhaps taking the place of old ones which are either realised or written off. This item and the previous item of fixed assets are obviously difficult accounting points in the balance sheets.

In the disturbed years 1912-20, when its investments were low and its lock-up in land and property were negligible, the ratio of cash to deposits was rarely below 15 per cent. and generally much above it. The situation has changed much in post-war years. The cash ratio has declined fluctuating within a wide margin of 4 to 8 per cent. but approaching the higher limit in recent years.

It would be an unwarranted misreading of the history and position of the bank to take the foregoing facts by themselves. An important clue to the position and policies of any bank lies in the composition of its deposit-liabilities. It should be noted that in the case of the Punjab National Bank, fixed and savings deposits are apt to be as high as 75 and at times even 80 per cent. of its total deposits. Its limited obligations on account of current accounts permits it a degree of freedom which would be inappropriate and even imprudent in the case of other banks. In this connection, it is well to point out that the bank made an unaccountable change in its presentation of figures in 1937. Till that year, savings deposits were included under the head "fixed deposits." From that year, savings deposits are coupled with current deposits. Since current deposits have been running low in recent years, the change is to be regretted as raising suspicion of a desire on the part of the authorities to conceal the fact.

* See the foot note on the previous page.

The bank had in 1938, 48 branches the bulk of which was concentrated in the Punjab. Its resources per branch averaged to Rs. 15 lakhs only. Among the Big Five, it has the smallest volume of resources per branch.

Like some other Indian joint stock banks, the Punjab National Bank has had its difficulties and its critics. The report of December 1916 notes "with regret that the *Arya Patrika*, which recently started, made a mountain out of a molehill by its dark references to the loss the bank may suffer by the conduct of the local director of the Ludhiana branch." Actually, the loss could not have exceeded Rs. 45,000. The bank suffered another small mishap in June 1917 when its accountant and cashier of the Bombay branch absconded with Rs. 45,000. The selection of bank personnel and the control and inspection of branches are, it is to be very much feared, very weak points with many Indian banks.

The average rate paid by the bank on its deposits tends to be a little lower than what is paid by the Allahabad Bank whose rates tend to the highest among the Big Five. More than 4 per cent. during the war, the average was a little higher during the twenties and declined faster than the rate of the Allahabad Bank during and after the Depression. But its rate of earning has been always inferior to that of the Allahabad bank while its ratio of expenses is the highest among the Big Five.

Before the Depression, the bank had paid dividends as high as 7 (1903), 10 (1912) and 15 per cent. (1927). In recent years, it has maintained it at much more modest levels, 5 to 6 per cent. in fact. The value of its shares which once were quoted as high as Rs. 161-171 (1927) declined fast to 51-80 in the dark depression year 1933 and are now quoted at about par.

TABLE XIX Punjab National Bank. (Dec. 31st.)

	Paid-up Capital	Reserves.	Total.	Saving Banks & cash certificates &Fixed deposits	Current account (credit balance).	Total Deposits.	Loans Cash Cr. P-notes, Bills & Demand Adv.	Govt. Security.	Govt. guaranteed Debentures & M'pal Loans.	Fully or partly paid Pref. and Ordy. shares of Jt.-Stock Cos.	Total Investment 8+9+10.	Lands, Bldgs., Machinery.	Cash.	Total Earnings 000s.	Interest paid to Depositors 000s.	Gross Profits. 000s.	Net Profits 000s.	Salary. 000s.	Total expense 000s.
1896	0.77	0.2	0.79	...	...	4.74	...	...	...	...	...	...	...	...	...	...	...	...	...
1900	1.59	0.25	1.84	...	...	18.06	...	...	...	...	...	...	...	...	...	...	...	...	...
1906	4.17	2.00	6.17	...	...	47.18	...	...	...	...	...	...	...	...	...	...	...	...	...
1910	8.32	6.00	14.32	...	...	116.8	...	...	...	...	...	...	...	...	...	...	...	...	...
1911	8.60	7.50	16.10	...	...	133.4	...	...	...	...	...	...	...	...	...	...	...	...	...
1912	9.7	8.5	18.2	128	23 incl saving deposit	147	138	15.7	8.4	...	24.1	1.58	10.7	...	...	714	297	118	417
1913	10.0	10.4	20.4	120	12 (,,)	132	91	15.7	12.8	...	28	1.96	33.2	...	...	...	277	122	...
1914	13.1	10.9	24	64	13 (,,)	77	67	14.9	12.8	...	27	1.96	11.0	...	...	415	175	120	240
1915	16.1	10.1	26.2	64	19 (,,)	83	74	11.1	12.6	...	23	1.96	12.7	...	...	357	178	110	179
1916	16.3	11.3	27.6	85	25 (,,)	110	92	16.2	12.6	...	20	2.03	19.5	...	...	441	205	114	236
1917	16.4	11.6	28	79	30 (,,)	109	98	20.7	12.6	...	33	2.04	15.6	...	...	489	228	...	261
1918	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1919	16.5	13.4	29.9	188	64	252	212	24.2	12.6	...	36.8	2.31	39	...	...	...	...	...	...
1920	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1921	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1922	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1923	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1924	30.6	22.3	52.9	507	119	626	463	126		...	126	13.8	78	...	1925	1845	199	...	926
1925	30.8	23.5	54.3	580	124	704	513	......		...	186	17.8	90	...	1926	1666	642	...	1024
1926	30.9	23.0	54.0	622	163	785	509	227	18	6.5	252	30.2	57	...	...	1661	558	...	1103
1927	31.1	22.2	53.3	587	144	732	501	218	21	7.5	247 (T.B.5)	40.8	54	...	...	1628	484	...	1144
1928	31.1	14.5	45.6	544	184	728	473	199	19	6.6	224 *	56	85	...	...	1699	551	...	1148
1929	31.2	17.0	48.2	408	130	538	354	184	19	6.1	208 *	57	33	...	...	1539	281	...	1258
1930	31.2	19.0	50.2	306	157	537	328	183	19	3.6	206	59	37	...	...	1396	196	...	1267
1931	31.2	21.2	52.4	304	99	403	272	183	18.6	2.6	204	76	19	...	...	1071	85	...	986
1932	31.2	21.2	52.4	290	141	431	262	142	18.6	2.6	163	78	21	...	...	1436	151	...	1285
1933	31.2	21.2	52.4	303	151	455	291	152	18.6	2.6	173	69	27	...	...	1965	181	...	1784
1934	31.2	21.0	52.2	303	196	472	326	130	10.4	9.8	150	82	27	...	...	1759	183	...	1576
1935	31.3	21	52.0	347	199	547	285	172	10.9	10.2	192	89	53	...	...	1738	188	...	1550
1936	31.3	20	51.0	396	213	609	366	145	25.1	18.3	188	92	53	...	...	2088	260	...	1828
1937	31.3	21	52.0	565	131	696	395	152	36	13.2	201	97	58	...	1938	2126	503	...	1628
1938	31.4	21	52.0	541	137	678	426	127	39	14.0	181	96	52	...	...	...	...	...	...

* Due to Bankers. 1929—41, 1931-118, 1932-35, 1934-66, 1935-28, 1936-50, 1937-11, 1938-34,

TABLE XX
Punjab National Bank
(Percentage to Deposits)

	Paid-up Capital and Reserve.	Fixed deposits, Savings Bank and Cash certificates.	Loans, Cash cerdits, Promo-tes, Bills, De-mand Advances	Govt. Securities.	Govt. guara-nteed Debent-ures and M'pal Loans.	Fully or Partly paid Pref.and Ordinary Shares.	Investments 4+5+6.	Lands, Buildings, Machinery.	Cash.
1896	16.6	...	...	...	...	...	...	...	...
1900	14.0	...	...	...	...	...	...	...	...
1906	13.0	...	...	...	...	...	...	...	...
1910	12.2	...	...	...	...	...	...	...	...
1911	12.0	...	...	...	...	...	...	...	...
1912	12.3	83.6	93.8	10.6	5.3	...	15.9	1.0	7.2
1913	15.4	90.9	68.9	11.8	9.6	...	21.4	1.4	25.1
1914	31.1	88.1	87.1	19.6	16.6	...	36.2	2.5	14.2
1915	31.3	77.1	89.1	13.3	15.1	...	28.4	2.3	15.3
1916	14.5	77.2	83.6	14.7	11.4	...	26.1	1.8	17.7
1917	25.6	72.4	89.9	18.9	11.5	...	30.4	1.8	14.3
1918	...	...	...	...	...	...	...	...	...
1919	11.5	74.6	84.0	9.6	5.0	...	14.6	0.9	15.4
1920	...	...	...	...	...	...	...	...	...
1921	...	...	...	...	...	...	...	...	...
1922	...	...	...	...	...	...	...	...	...
1923	...	...	...	...	...	...	...	...	...
1924	8.4	80.9	73.9	20.1		...	20.1	2.2	12.4
1925	7.6	82.3	72.8	...	...	...	26.0	2.5	12.7
1926	6.8	79.2	64.8	28.9	2.2	0.8	31.9	3.8	7.3
1927	7.2	80.1	68.4	29.0	2.8	1.0	32.8	5.5	7.3
1928	6.1	74.7	64.9	27.3	2.6	0.9	30.8	7.6	11.6
1929	8.9	75.8	65.7	34.2	3.5	1.1	38.8	10.5	6.1
1930	9.3	70.7	61.0	34.0	3.5	0.6	38.1	10.9	6.3
1931	12.9	75.4	67.4	45.4	4.6	0.6	50.6	13.3	4.7
1932	12.0	67.2	60.7	32.9	4.3	0.6	37.8	13.0	4.3
1933	11.4	66.5	63.9	33.4	4.0	0.5	37.9	15.1	5.9
1934	11.0	64.1	69.0	27.5	2.2	2.0	31.7	17.3	5.7
1935	9.5	63.4	52.1	31.4	1.9	1.8	35.1	16.2	9.6
1936	8.8	65.0	60.0	23.8	4.1	3.0	30.9	15.1	3.7
1937	7.4	81.1	56.7	21.8	4.5	1.8	28.1	13.9	3.3
1938	7.6	79.7	62.8	18.7	5.7	2.0	26.4	14.1	7.6

The Allahabad Bank*

The Allahabad Bank of India is the oldest among " Indian " joint-stock banks. Registered in 1865 at Allahabad, it started operations in the same year with a paid-up capital of 1·9 lakhs and hardly any deposits. It raised its capital to 3 lakhs by 1870, 4 lakhs by 1890 and 5 lakhs by 1900. A small reserve fund of Rs. 3000 only was launched in 1867 and with small additions was raised to about 1 lakh in 1880, a little above 3 lakhs in 1890 and almost 10 lakhs in 1900.

The progress of deposits was very slow, ·80 per cent. of deposits in 1870, its capital and reserve still amounted to as much as 22·8 per cent. as late as 1880. After 1880, the progress was quickened but it was during the remarkable closing decade of the last century* that the bank grew to impressive size. Its deposits which amounted to 59 lakhs only in 1890 passed 2 crores by 1900. The ratio of capital and reserve to deposits sank from 12·3 per cent. in 1890 to as low as 6·6 per cent. in 1900.

It adopted a cautious policy of expansion. It opened its first branch at Cawnpore as late as 1888 when its aggregate resources were well over 40 lakhs. Even after the outbreak of the Great War, its branches numbered only 12 in 1917, when its aggregate resources amounted to more than 6 crores. The subsequent growth was a little more rapid. In 1938, its branches, including two pay-offices, numbered 56 and were largely concentrated in the Punjab and the U.P. Its resources per branch thus aggregate to Rs. 20 lakhs on the average.

In 1922, the P. & O. Banking Corporation made an offer of affiliation which was accepted with great eagerness, 90 per cent. of the shareholders voting in favour. The P. & O. Banking Corporation offered a price of Rs. 436 per fully paid share of Rs. 100 when the highest pre-war quotation for it was Rs. 365 and the quotation during the hectic days of

* Table I and XXII

1920 was never above Rs. 300. From the earliest days, the Allahabad Bank had never been free of European influence and management but now its subjugation was complete and official.

In 1927, a further change in the same direction occurred. The Chartered Bank of India, Australia and China purchased 196,059 out of 259,416 shares of the P. & O. Banking Corporation. A great exchange bank thus acquired an overwhelming foothold in the interior of the country.

The progress of deposits during the first decade of the present century and the Great War was so rapid that in spite of the quadrupling of the paid-up capital and reserve of the bank in the first twenty years, their ratio to deposits remained low at about 7 to 8 per cent. The subsequent history reveals a stabilisation of resources and the ratio.

During the war years, it kept its investments prudently low and maintained its advances and loans at about 60 per cent. and more. The policy was reversed after the War, loans and advances falling to about 50 per cent. and less and investments increasing from less than 5 per cent. to 20 and later 30 per cent. The stagnation of post 1929 years confirmed the trend, loans and advances sinking below 40 per cent. and investments improving to 40 per cent. and more.

Almost the whole of its investment portfolio consists of government securities. Since 1922, the Bank developed for some time and the practice of holding 2 to 4 per cent. of its deposits as Short Deposits with other banks. Its portfolio of bills has been always substantial, generally exceeding 8 per cent. but in recent years as in the case of all the other banks, it has fallen very low—as low as 2 per cent.

At no time during the last 30 years has the cash ratio fallen below 10 per cent, and more often than not, it has

been above 15 per cent. When treasury bills were available at the fall of the year, it has tried to lay by a stock of them—sometimes as high as 10 per cent. and more of its deposits. These facts taken together indicate how the bank has been strong in its desire to maintain a liquid position. When it is recalled that its fixed deposits tend to be about 70 per cent. of the total *i.e.* lower than in the case of the Punjab National Bank only, its position appears almost impregnable. Besides, we must note that recent years have seen a remarkable growth of Saving Deposits, which as a point of strength stand midway between fixed and current deposits. Till the year of affiliation, saving deposits never exceeded 2·5 per cent. of the total. Since then, they have grown fast till by 1936-37, they were higher than 11 per cent.

The Bank of Allahabad operates chiefly in the U.P. and the Punjab. Before and during the War, its rate of earnings used to be generally between 5 and 6 per cent. while the average rate offered on deposits varied between 2·5 and 5 per cent. The margin of gross profits was therefore quite a generous one—the rate working out at 2·0 and 2·5 per cent. Its ratio of expenses in those years was, however, inferior to those of the Imperial Bank of India, Bank of Baroda and the Bank of India only and its net profits rate was quite respectable—varying between ·75 and 1·0 per cent.

In the period of high interest-rates and more acute competition which succeeded the war, the Allahabad Bank has been paying rates on its deposits which are generally higher than those of any other bank barring the Indian Bank of Madras which however is in a class by itself. Before the Depression, the average rate on deposits was generally between 4·5 to 5·5 per cent. and even 6 per cent. and since then, it has fallen to somewhere below 4 per cent. The rate of earning had increased to somewhere between 6·5 and 7·5 per cent. in pre-Depression years and fell to 5 per

cent. thereafter, leaving practically the same profit margin as before.

The expense ratio of the bank has, however, gradually moved up and shows no fall even after the Depression. The creation of branches explains it very largely—the average resources being only 20 lakhs per branch which is more than twice the figure for the Indian bank but less than the figure for any other of the Big Five. The Allahabad Bank deserves commendation on the ground that among the Big Five, it has always devoted a good fraction of its gross profits to salaries of employees. Even before 1920, this fraction was well maintained at 40 per cent. and above. But since then, more branches have come into existence and the fraction of salaries has mounted up to 55 per cent.

The rate of net profits, always lowest among the Big Five has fallen still further after 1920. It has maintained itself with difficulty at ·50 per cent.

Its rate of dividend was 15 per cent. till 1905, rose to 17 per cent. in 1906 and 16 per cent. in 1908—the last rate being maintained consistently till now. Its reserve fund has stood about the same figure as in the last War, which means that net profits have been entirely used to bolster up the dividend rate. During the War, much less than half the net profits used to be paid in dividends—which was certainly a very conservative policy. The price of its ordinary shares which stood between Rs. 254 to 270 as early as 1907 rose to Rs. 355 to 365 in 1923 and declined to less than Rs. 300 by 1920.

TABLE XXI

The Allahabad Bank of India.

(Dec. 31st)

(Figures in 000s till 1890 inclusive and in lakhs thereafter)

	Paid-up Capital.	Reserve Fund.	Capital and Reserve Fund.	Fixed Deposits	Saving Deposits.	Current Deposits	Total Deposits	Total Liabilities	Loans.	Cash Credits and Other Drafts	Bills Discounted	House Property	Government Securities.	Other Trust Securities	Cash
1865	190	...	190	37	...	35	72	262	59	88	88	...	...	...	33
1866	282	...	282	14	...	34	48	330	98	112	29	...	...	...	12
1867	285	3	288	39	...	39	78	366	140	95	38	...	...	...	25
1868	285	6	291	111	...	96	207	498	202	91	118	10	...	...	74
1869	286	10	296	203	...	96	299	595	349	129	66	11	...	...	39
1870	300	13	313	373	...	104	477	790	402	141	72	11	12	...	98
1871	300	17	317	453	...	173	626	943	423	90	68	11	8	...	89
1872	300	22	322	534	...	160	694	1016	570	108	93	11	13	...	106
1873	300	28	328	573	...	174	737	1065	550	196	48	11	25	...	153
1874	300	35	335	617	...	186	803	1138	502	201	31	11	35	...	246
1875	300	40	340	675	...	272	947	1287	507	321	80	11	40	...	248
1876	300	46	346	880	...	244	1124	1470	664	462	72	22	47	...	138
1877	300	58	358	1087	...	303	1390	1748	687	429	81	47	58	...	221
1878	300	67	376	1159	...	333	1492	1859	724	296	84	37	69	...	338
1879	300	78	378	1382	...	293	1675	2053	1046	318	119	37	79	...	370
1880	300	91	391	1631	...	328	1959	2350	1196	254	189	32	91	...	441
1881	300	104	404	1915	...	404	2319	2723	1310	286	399	32	104	...	374
1882	300	116	416	2115	...	483	2608	3024	1296	359	247	32	117	...	985
1883	300	129	429	2252	...	475	2727	3156	1599	550	164	33	128	...	586
1884	300	145	445	2532	...	338	2870	3315	1601	634	135	33	144	...	563
1885	300	163	463	2824	...	424	3248	3711	1838	513	178	33	162	...	868
1886	300	183	483	3109	...	542	3651	4134	2058	538	191	33	179	...	949
1887	300	205	505	3275	...	510	3765	4270	1951	462	149	33	200	...	1164
1888	300	229	529	3803	...	749	4552	5081	2480	645	590	56	229	...	788
1889	300	255	555	4676	...	818	5494	5949	2979	838	818	67	254	...	731
1890	400	336	736	5909	...	1094	7003	7739	3517	941	801	91	324	...	1544
1891	4	3.6	7.6	73.4	...	13.22	86.6	93.2	87.4	10.2	19.0	0.9	3.7	...	12.1
1892	4	4.0	8.0	87.7	...	14.3	102.0	110.0	51.9	11.4	18.5	1.6	4.0	...	13.2
1893	4	4.4	8.4	98.1	...	16.3	114.4	122.8	52.4	11.6	26.2	1.7	4.3	...	16.6
1894	4	4.8	8.8	112.7	...	15.9	28.6	137.4	57.1	17.8	28.3	1.6	4.7	...	15.1
1895	4	5.1	9.1	141	...	18.3	159.3	168.4	61.5	26.1	39.3	1.6	5.1	...	20.3
1896	5	5.6	10.6	158	...	20.9	178.9	189.5	71.3	34.1	44	1.7	5.6	...	23.8
1897	5	6.7	11.7	163	...	22.4	185.4	197.1	64.7	40.9	51.6	1.8	6.5	...	23
1898	5	7.8	12.8	169	...	21.4	190.4	203.2	70.2	42.8	39.2	2.1	7.7	...	32.8
1899	5	8.6	13.6	191	...	25.8	216.8	230.4	82.3	69.6	35.5	2.3	8.7	...	19.9
1900	5	9.5	14.5	216	...	32.4	248.4	262.9	88.7	76.8	42.4	2.2	9.6	...	30.6
1901	10	10.5	20.5	241	...	31.6	272.6	293.1	88.4	69.9	65.2	2.7	11.7	...	58.7
1902	10	11.5	21.5	259	...	37.8	296.8	318.3	104	75.8	62.3	2.7	12.6	...	40.9
1903	10	12.3	22.3	294	...	39.4	333.4	355.7	115	68	81	2.7	13.7	...	37.0
1904	15	13	28	312	...	39.1	351.1	379.1	133	85	67	2.6	14.6	...	38.1
1905	15	14	29	332	...	43.5	375.5	404.5	145	115	61	2.8	15.9	...	36.3
1906	15	16	31	361	...	43	404	435	138	140	59	2.5	18.1	...	49.1
1907	20	23	43	380	...	49	429	472	141	156	84	2.8	25	...	47.1
1908	20	25	45	387	2.1	44.8	433.9	478	147	158	67	3.2	27.6	...	50.9
1909	20	29	49	424	4.6	49.2	477.8	526	157	136	94	4.3	31.8	...	61.7
1910	20	30	50	490	7.6	54.9	552.5	602	154	169	141	9.1	32.8	...	68.3

The Allahabad Bank of India—*continued*

	Paid-up Capital.	Reserve Fund.	Total.	Fixed Deposits.	Savings Deposits.	Total Fixed Deposits 4+5.	Current Deposits and Contingencies.	Total Deposits 6+7.	Total Liabilities 3+8.	Loans.	Cash Credits and Overdues.	Bills Discounted and Pro-Notes.	House Property.	Govt. Securities.	Other Securities.	Total Investments 14+15.	Cash and Call money.	Total earnings 000s.	Total Interest paid Depositors 000s.	Gross Profits 000s.	Net Profits 000s.	Salaries and contribution to Provident fund 000s.	Other expenses 000s.
1911	20	34	54	...	...	...	...	612	676	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1912	20	36	56	...	...	...	...	649	705	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1913	25	36	61	609	9	618	57	676	737	168	246	136	17	14	...	14	124	4194	2837	1257	572	527	107
1914	30	43	73	447	7	454	66	521	594	170	181	88	18	12	...	16	82	3672	2343	1329	525	543	113
1915	30	45	75	408	11	419	97	517	592	136	165	87	20	11	...	15	129	3160	1852	1308	533	536	114
1916	30	45	75	394	14	408	138	546	621	127	188	79	20	12	...	16	152	3282	1867	1415	601	552	128
1917	30	48	74	427	14	...	147	589	663	104	223	84	22	24	...	...	169	...	...	...	...	...	...
1918	30	34	64	538	16	554	109	724	788	96	323	100	20	30	...	34	183	4002	2566	1636	604	639	166
1919	30	30	60	706	20	726	210	936	996	89	516	102	19	27	...	31	214	5227	3410	1817	611	773	183
1920	35	35	70	685	21	706	228	934	1004	82	478	97	21	13(T.B.2)	...	17	240	7092	4644	2448	1001	956	198
1921 Sept.	35	35	70	776	26	...	310	...	1112	87	475	98	22	139	...	...	215	...	...	...	...	...	...
1922 31st. March	35	35	70	776	27	803	249	1053	1123	84	492	93	28	88 (T.B. 67)		190 (incl. 40 Deposits)	206	3640	2431	1209	235	629	130
1923 "	35	35	70	717	28	745	347	1093	1163	87	442	127	33	107	...	183 (31)	271	7679	5175	2495	492	1336	260
1924	35	35	71	615	24	639	209	849	920	80	371	78	35	120	...	145 (20)	193	7724	5025	2750	780	1344	268
1925	35	44	80	667	32	699	217	916	996	76	385	77	36	154	...	158 (8)	219	6539	4049	2490	502	1301	246
1926	35	44	80	666	43	709	225	935	1015	68	397	80	38	202	...	247 (40)	148	7067	4637	2450	531	1294	247
1927	35	44	80	698	51	749	256	1006	1086	66	424	67	39	242	...	291 (23)	161	7969	5449	2520	567	1345	251
1928	35	44	80	740	58	798	228	1027	1107	58	418	73	40	270	...	348 (T.B.48)	190	7945	5378	2567	572	1430	...
1929	35	44	80	835	67	902	217	1119	1199	60	469	89	44	292	...	345 (T.B.24)	158	8210	5702	2508	578	1427	...
1930	35	44	80	804	75	879	256	1136	1216	61	389	69	43	326	...	432(T.B.132)	183	8686	6021	2665	600	1494	...
1931	35	44	80	783	82	865	236	1102	1182	47	347	74	45	354	...	561(183T.B.)	119	9114	6464	2650	551	1514	...
1932	35	44	80	721	77	798	195	994	1074	79	264	40	45	379	...	531(T.B.129)	127	8741	6240	2501	554	1433	...
1933	35	44	80	755	96	851	229	1081	1161	71	325	27	48	504	...	582(T.B.55)	123	8309	5849	2460	574	1376	...
1934	35	44	80	673	106	779	245	1025	1105	67	365	19	47	458	...	486	188	7617	5020	2697	590	1331	...
1935	35	44	80	665	107	772	237	1011	1091	62	466	19	43	329	...	355	165	6576	3847	2729	615	1411	...
1936	35	44	80	614	109	723	251	976	1056	56	300	15	41	385	...	407	255	5862	3247	2615	564	1440	...
1937	35	46	82	628	124	752	294	1047	1129	55	534	15	41	333	...	342	167	...	...	2911	...	...	...
1938	35	48	83	632	146	778	299	1077	1160	56	497	14	40	370	45	415	159	4460	1549	...	887	1421	211
1939	35	50	85	608	159	767	327	1095	1180	60	462	14	46	408	44	447(T.B+10)	158	...	...	...	...	...	...

TABLE XXII

The Allahabad Bank of India.

(Percentage of Deposits)

	Capital and Reserve.	Fixed Deposits.	Savings Deposits.	Loans.	Cash Credits and Over drafts.	Bills Discounted.	House Property.	Government Securities.	Other Trust Securities.	Cash.
1865	263.8	51.8	...	81.9	52.7	45.8	...	...	...	45.8
1866	587.5	29.1	...	204.1	283.8	60.4	...	...	...	25.8
1867	865.8	50.0	...	179.4	121.7	48.7	...	...	...	82.0
1868	187.6	58.6	...	97.5	48.9	57.0	4.8	...	...	85.7
1869	98.9	67.8	...	85.6	48.1	22.0	8.6	...	...	18.0
1870	65.6	78.1	...	84.2	29.5	15.1	2.8	2.5	...	20.5
1871	50.6	72.8	...	67.5	14.8	10.8	1.7	1.2	...	14.8
1872	46.8	76.9	...	82.1	14.8	18.4	1.5	1.8	...	15.2
1873	44.5	77.7	...	74.6	26.5	5.8	1.4	8.8	...	20.7
1874	41.7	76.8	...	62.5	25.0	8.8	1.8	4.8	...	80.6
1875	85.9	71.2	...	58.5	88.8	8.4	1.1	4.2	...	26.1
1876	80.7	78.2	...	59.0	41.2	6.4	1.9	4.1	...	12.2
1877	25.7	78.2	...	49.4	80.8	5.8	8.8	4.1	...	15.9
1878	24.5	77.6	...	48.5	19.8	5.6	2.4	4.6	...	22.6
1879	22.5	82.5	...	62.4	18.9	7.1	2.2	4.7	...	22.0
1880	19.9	88.2	...	61.0	12.9	9.6	1.6	4.6	...	22.5
1881	17.4	82.5	...	56.4	12.8	17.2	1.8	4.4	...	16.1
1882	15.9	81.0	...	49.6	18.7	9.4	1.2	4.4	...	87.7
1883	15.7	82.5	...	58.6	20.1	6.0	1.2	4.6	...	19.7
1884	15.5	88.2	...	58.9	22.0	4.7	1.1	5.0	...	19.6
1885	14.2	86.9	...	56.5	15.8	5.4	1.0	4.9	...	26.7
1886	18.2	85.1	...	56.8	14.5	5.1	1.0	4.9	...	25.9
1887	18.4	86.9	...	51.8	12.2	8.9	0.9	5.8	...	80.9
1888	11.6	88.5	...	58.8	14.2	12.9	0.8	5.0	...	17.8
1889	10.1	85.1	...	54.2	15.2	14.8	1.2	4.6	...	18.8
1890	10.5	84.8	...	50.2	18.4	11.4	1.2	4.6	...	22.0
1891	8.7	84.7	...	48.1	11.7	21.9	1.0	4.8	...	14.0
1892	7.8	85.9	...	50.8	11.1	18.0	1.5	8.9	...	12.9
1893	7.8	85.7	...	45.8	10.1	22.9	1.4	8.7	...	14.5
1894	6.8	87.6	...	44.4	18.8	22.0	1.2	8.6	...	11.7
1895	5.7	88.5	...	88.6	16.8	24.6	1.0	8.2	...	12.7
1896	5.9	88.8	...	89.8	19.0	24.9	0.9	8.1	...	18.8
1897	6.8	87.9	...	84.8	22.0	27.8	0.9	8.5	...	12.4
1898	6.7	88.7	...	86.8	22.4	20.5	1.1	4.0	...	17.2
1899	6.2	88.1	...	87.9	82.1	16.8	1.0	4.0	...	9.2
1900	5.8	86.9	...	85.7	80.7	17.0	0.8	8.8	...	12.8
1901	7.5	88.4	...	82.4	25.6	28.9	0.9	4.8	...	21.5
1902	7.2	87.2	...	85.1	25.8	20.9	0.9	4.2	...	18.8
1903	6.6	88.1	...	84.5	20.4	24.2	0.8	4.1	...	11.1
1904	7.8	88.8	...	87.8	24.2	19.0	0.7	4.1	...	10.8
1905	7.7	88.4	...	88.6	80.6	16.2	0.7	4.2	...	9.6
1906	7.6	89.8	...	84.1	84.6	14.6	0.6	4.4	...	12.1
1907	10.0	88.5	...	82.8	86.8	19.5	0.6	5.8	...	11.1
1908	10.8	89.1	0.4	88.8	86.4	15.4	0.7	6.8	...	11.4
1909	10.2	88.7	0.9	82.9	28.5	19.6	0.9	6.6	...	12.9
1910	9.0	88.6	8.8	27.8	80.6	25.5	1.6	5.9	...	12.8

The Allahabad Bank of India—*Contd.*

(Percentage to Deposits)

	Capital and Reserve.	Fixed Deposits.	Savings Deposits.	Fixed and Saving Deposits.	Loans.	Cash Credits and Over drafts.	Bills Discounted & Promotes.	House Property.	Govt. Securities.	Other Trust Securities.	Total Investments 9+10.	Treasury Bills.	Cash and Call money.
1906	...	...	...	...	...	...	...	...	...	...	...	...	...
1907	...	...	...	...	...	...	...	...	...	...	...	...	...
1908	...	...	...	...	...	...	...	...	...	...	...	...	...
1909	...	...	...	...	...	...	...	...	...	...	...	...	...
1910	10.0	...	...	...	...	...	...	...	...	...	...	...	...
1911	8.8	...	...	...	...	...	...	...	...	...	...	...	...
1912	8.6	...	...	...	...	...	...	...	...	...	...	...	...
1913	9.0	90	1.3	91.3	24.8	36.3	20.1	2.5	2.0	...	2.0	...	18.3
1914	14.0	85.7	1.3	87	82.6	34.7	16.8	3.4	2.3	...	3.0	...	15.7
1915	14.5	78.9	2.1	81	26.3	31.9	16.8	3.8	2.1	...	2.9	...	24.9
1916	13.7	72.1	2.5	74.6	23.2	34.4	14.4	3.6	2.1	...	2.9	...	27.8
1917	...	...	...	...	...	...	...	...	...	...	...	...	...
1918	8.8	74.3	2.2	76.5	13.2	44.6	13.8	2.7	4.1	...	4.6	...	25.9
1919	6.4	75.4	2.1	77.5	9.5	55.1	10.8	2.0	2.8	...	3.3	...	23.3
1920	7.4	73.3	2.2	75.5	8.7	51.1	10.3	2.2	1.1	...	1.3	0.2	25.6
1921	...	...	...	...	...	...	...	...	...	...	...	...	...
1922	6.6	73.6	2.5	76.1	7.9	46.7	8.8	2.6	7.8	...	18.0‡ (3.8)	6.8	19.5
1923	6.4	66.2	2.5	68.7	7.9	40.4	11.6	3.0	9.7	...	16.7 (2.8)	...	24.3
1924	8.3	72.4	2.8	75.2	9.4	43.6	9.1	4.1	14.1	...	17.0 (2.3)	...	22.7
1925	8.7	72.3	3.4	75.7	8.2	42.0	8.4	3.9	16.8	...	17.2 (0.2)	...	23.9
1926	8.5	71.2	4.5	75.7	7.2	42.4	8.5	4.9	21.6	...	26.4 (4.2)	...	15.8
1927	7.9	69.3	5.0	74.3	6.5	42.1	6.6	3.8	24.0	...	28.9 (2.2)	...	16.0
1928	7.7	72.0	5.6	77.6	5.6	40.2	7.1	3.8	26.2	...	29.2	4.6	18.5
1929	7.1	74.6	5.9	80.5	5.3	41.9	7.9	3.9	26.0	...	28.7	2.1	13.9
1930	7.0	70.6	6.6	77.2	5.3	34.2	6.0	3.7	28.7	...	30.6	11.6	16.1
1931	7.2	71.0	7.4	78.4	4.2	31.4	6.7	4.0	32.1	...	30.8	16.6	10.8
1932	8.0	72.5	7.7	80.2	7.9	26.5	4.0	4.5	38.1	...	40.5	12.9	12.7
1933	7.4	69.8	8.8	78.6	6.5	30.0	2.4	4.4	46.6	...	48.8	5.0	11.8
1934	7.8	65.6	10.3	75.4	6.5	35.6	1.8	4.5	44.6	...	47.4	...	13.4
1935	7.9	65.7	10.5	76.2	6.1	46.0	1.3	4.2	32.5	...	35.1	...	16.8
1936	8.1	62.9	11.1	74.0	5.7	30.7	1.5	4.2	39.4	...	41.7	...	26.1
1937	7.8	59.9	11.8	71.7	5.2	51.0	1.4	3.9	31.8	...	32.6	...	15.9
1938	7.7	58.6	13.5	72.2	5.2	46.1	1.2	3.7	34.3	4.1	38.3	...	14.7
1939	7.7	55.5	14.5	70.0	5.4	42.1	1.2	4.2	36.8	4.0	40.8	0.1	14.7

The Bank of Baroda*

The Bank of Baroda was established in 1909 under the patronage of the enlightened Ruler of that State and with an assured volume of working resources as incidental to the management of State revenues and expenditure. As early as 1912, its deposits reached the neighbourhood of 1 crore and the ratio of capital and reserve to deposits stood well above 10 per cent. When the Great War inflated its deposits from about 1 crore in 1914 to more than 5 crores in 1920, the authorities took the precautionary step of raising its capital and reserve to 20 and 12 lakhs respectively in 1918 in the first instance and again in 1921 to 30 and 17 lakhs respectively. Its reserve has been steadily augmented till in 1938 it reached 25 lakhs. The progress of deposits has been however so steady that the capital and reserve ratio has not been much above 8 or 9 per cent. and sometimes indeed has fallen below these levels.

The bank opened its first branch at Bombay in 1919. By 1938, it had established 23 branches most of which were concentrated in Gujarat and Kathiawar. Its average resources per branch stood in that year at a respectable figure of more than 30 lakhs.

Except for the years of the Great War, when the percentage to deposits exceeded 80 and even 90, the aggregate of loans and advances has been generally less than 55 per cent. and in the recent post-Depression years, it has been as low as 30 per cent. Its bill-portfolio has occasionally reached arresting size but as a post-war practice, the bank has been inclined to find a larger and larger outlet for its funds in investments. Government

* Tables XXIII and XXIV.

securities account for as high a percentage of deposits as 30, 35 and 40 per cent. but post-war years have witnessed a remarkable rise in Railway and other Debentures and Ordinary Shares of public companies. During the present decade, these latter investments have been well above 15 per cent.

The bank has maintained a high cash ratio. Generally above 15 per cent., it has never fallen below 12 per cent. Till the Depression produced its effects in recent years, the proportion of fixed deposits was rarely below 60 per cent.

Most banks in India suffer from time to time from some chronic malady which public imagination attaches to it as its special weakness. The malady to which the Bank of Baroda is prone is periodic rumours of withdrawal of State funds and support. In 1925 and again in November 1933, these rumours, even though utterly unfounded, succeeded in causing temporary runs on the bank.

Its rate of gross profits is the lowest among important Indian banks—and till recently showed a tendency to decline. Well over 2 per cent. during and before the Great War, it has fluctuated very much thereafter, being generally between 1·40 and 1·60 per cent. This modest rate may be partly due to the high liquidity of the bank's assets in general. We have noted the high proportion of its cash and its investments. Partly, this should be ascribed to the fact that its chief area of operation is Gujarat and Kathiawar where funds are relatively more abundant and competition among banks and private lenders decidedly keen.

Its expense ratio is also low, being inferior only to the Bank of India's. The Bank of Baroda has only a few

branches and its average resources per branch are high, being somewhat smaller than the Central Bank's. Till 1933, its expenditure on salaries also was less than that of any other bank—being less than 30 per cent. of its gross profits. A large volume of resources relatively to the size of the organisation is probably a part of the secret of its low expenses ratio.

Although the rates of gross profits and the expenses ratio are both low, the former is relatively so modest that the difference between them *i.e.* the rate of net profits compares unfavourably with those of the Imperial Bank, the Central Bank of India and the Bank of India. The rate also shows a progressive decline. Well over 1·00 per cent. before 1924, it has never reached those levels again, ·60 to ·80 per cent. being the usual range.

Altogether, the bank seems to have reached the maximum point of exploitation of the area over which it operates. For further growth and conquest, it must look in the future more and more to other parts of the country and to other lines of business.

TABLE XXIII

The Bank of Baroda (Dec. 31)

(Figures in Lakhs)

	Paid-up Capital.	Reserve (incl. that for doubtful debts).	Total 1+2.	Fixed Deposits.	Current Savings and other Accounts.	Total Deposits 4+5.	Total Liabilities	Cash Credits and Overdrafts.	Loans.	Bills Discounted.	Immovable Properties.	Govt. Securities at or below cost.	Rly. & other Debentures and Shares in Public Co's at or below Mkt. rate	Total Investment 12+41.	Treasury Bills.	Cash in hand and at Bank	Gross P'fits.(ex-contribution of Baroda Govt.)	Net profits.	Salaries.	Other expense
1910	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1911	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1912	10	1.2	11	92		92	108	76		00.6	...	...	...	...	...	27	249	192	39	4
1913	...	...	...			...	...			...	...	...	...	...	...	...	...	...	...	...
1914	10	3.7	13	59	34	93	106	86		...	...	2.2	...	...	...	20	268	181	52	6
1915	10	4.1	14	61	41	102	116	93		...	...	4.5	...	...	...	22	298	172	58	5
1916	10	5.5	15	92	49	141	156	135		...	...	4.7	...	...	...	20	338	220	65	7
1917	10	6.7	16	108	69	177	193	144		...	...	5.6	...	...	...	47	427	265	73	8
1918	20	12	32	115	90	205	237	11	152	0.4	...	14.4	...	...	...	61	498	349	88	12
1919	20	13	33	251	150	401	434	23	194	40.7	.37	80	...	...	...	100	630	383	129	25
1920	24	15	39	358	159	517	556	39	262	47.7	.56	81	8	89	...	124	889	582	173	35
1921	30	17	47	303	169	472	519	30	223	44	.59	116	7	123	...	101	1035	650	226	29
1922	30	19	49	319	157	476	525	40	223	4.6	18.7	117	17	135	...	77	1040	696	269	22
1923	30	20	50	328	192	520	570	34	228	6	18.7	167	18	135	...	87	1078	615	282	43
1924	30	20	50	318	163	481	531	20	204	4	18.6	190	19	209	...	85	992	531	285	39
1925	30	21	51	359	174	533	584	15	221	1	14.2	209	34	242	...	93	969	485	298	39
1926	30	22	52	339	224	578	625	35	213	8	15.3	179	69	249	...	101	1023	501	316	47
1927	30	22	52	324	226	550	602	50	166	46	17.1	202	78	280	...	92	1031	489	332	40
1928	30	23	53	353	206	559	612	59	186	65	17.3	176	89	265	...	87	951	421	341	47
1929	30	23	53	362	210	572	625	72	195	28	17.2	152	111	263	...	81	849	394	342	41
1930	30	24	54	368	228	596	650	60	211	...	17.0	124	96	298	77	68	894	361	348	48
1931	30	19	49	440	230	670	719	71	167	...	17.7	167	92	271	114	84	923	396	345	43
1932	30	20	50	423	309	732	782	57	142	...	17.6	305	82	388	92	92	949	406	338	44
1933	30	20	50	295	244	539	589	60	105	...	20.5	255	79	334	3	73	911	395	358	39
1934	30	21	51	312	316	628	679	76	160	...	21.1	263	68	331	...	98	952	447	296	40
1935	30	22	52	229	348	577	629	94	89	3	20.8	203	98	301	...	130	985	427	313	43
1936	30	23	53	305	393	698	746	105	141	2	22.2	245	114	359	...	122	1051	455	337	44
1937	30	25	55	284	395	679	734	187	99	12	21.6	209	103	312	...	107	1332	592	398	72
1938	30	25	55	306	406	712	768	185	100	14	20.9	202	107	309	25	119	1388	505	435	81

TABLE XXIV The Bank of Baroda

(Percentage to Deposits)

	Captial & Reserve.	Fixed Deposits.	Cash Credits and Over-drafts	Loans.	Bill discounted	Immovable Property.	Govt. securities at or below cash.	Rly. and other Debentures and Shares in Public Cos.	Treasury Bills.	Money at Call.	Cash.
1910	...	...	...	...	...	...	...	...	...	...	...
1911	...	...	...	...	...	...	...	...	...	...	...
1912	11.9	...	82.6		0.6	...	...	...	...	...	13.0
1913	...	...	......		...	...	...	...	...	...	...
1914	13.9	63.4	92.4		...	...	2.3	...	...	...	21.5
1915	13.7	59.8	91.1		...	...	4.2	...	...	...	18.9
1916	10.6	65.2	95.7		...	...	3.3	...	...	...	12.8
1917	9.0	61.0	81.3		...	...	3.1	...	...	...	24.3
1918	15.6	56.0	5.3	74.1	0.2	...	7.0	...	...	...	29.7
1919	8.2	62.5	5.7	48.5	10.1	...	19.1	...	...	...	25.0
1920	7.5	69.2	7.6	50.6	9.2	0.1	15.6	1.5	...	...	23.9
1921	9.3	64.1	6.3	47.2	9.3	0.1	24.5	1.4	...	...	21.3
1922	10.3	67.0	8.4	46.8	0.9	2.8	24.5	3.5	...	...	16.1
1923	9.6	63.0	6.5	43.8	1.1	2.6	32.1	3.4	...	7.3	16.7
1924	10.4	66.1	4.1	42.4	0.8	2.8	39.5	3.9	...	4.0	17.6
1925	9.5	67.3	2.8	41.4	0.2	2.6	39.2	6.3	...	...	17.4
1926	9.0	59.1	6.1	37.1	1.3	2.6	31.2	12.0	...	...	17.6
1927	9.4	58.9	9.0	30.1	8.3	3.1	36.7	14.1	...	...	16.7
1928	9.4	63.1	10.5	33.2	11.6	3.0	31.4	15.9	...	...	15.5
1929	9.2	63.2	12.5	34.2	4.8	3.0	26.5	19.4	...	...	14.1
1930	9.0	61.7	10.0	35.4	...	2.8	20.8	14.7	...	...	11.4
1931	7.3	65.6	10.5	24.9	...	2.6	26.7	13.7	1.7	...	12.5
1932	6.8	57.7	7.7	19.3	...	2.4	41.6	11.2	1.2	...	12.5
1933	9.2	54.7	11.1	19.4	...	3.8	47.3	14.6	...	...	12.3
1934	8.1	49.6	12.1	25.4	...	3.3	41.3	10.8	...	...	15.6
1935	9.1	39.6	16.2	15.4	0.5	3.6	35.1	16.9	...	...	22.5
1936	7.6	44.0	15.1	20.3	0.2	3.2	35.3	16.4	...	...	17.6
1937	8.1	41.3	27.5	14.5	1.7	3.1	30.7	15.1	...	...	15.7
1938	7.3	42.9	25.9	14.0	1.9	2.7	28.3	15.0	3.5	...	16.7
1939											
1940											

The Bank of Mysore*

The Bank of Mysore was established in 1912 with the active patronage and support of the State. Its paid-up capital was Rs. 10 lakhs, the State holding 1/3rd of its shares. The State retained in its hands the right of general supervision and, what was much more important in those days, the right of audit as well. A proportion of the directorate was to consist of State officials. The bank was entrusted with the management of state funds which, in the earlier years, equalled the paid-up capital of the bank.

In 1915, the aggregate liabilities amounted to about 50 lakhs of which the paid-up capital and State funds accounted for a little more than one half. By 1919 and 1920, the deposits of the bank reached 1 crore and on the eve of the 1929-30 crisis, nearly 2 crores.

During the Depression, the bank fairly maintained its ground and after the recovery of 1934-35 recorded further progress till its deposits reached 2½ crores in 1938.

A remarkable feature of its recent history is the impressive growth of savings deposits or as the balance-sheets describe it more appositely, "thrift deposits." Between 1914-1926, these deposits rarely amounted to 2 per cent. of total deposit-liabilities. After 1926, they increased progressively till in 1938, the percentage was well above 14.

Before the Depression, loans and advances of the bank were apt to be more than 75 per cent of deposits and it is significant that even after the Depression, the percentage has rarely fallen below 65 and even then, not in any appreciable degree. Its bill portfolio has rarely exceeded 5 per cent. of deposits.

As in the case of other banks, the conclusion of Peace and the expected fall in interest-rates proved a strong inducement to increase investments. Less than 5 per cent. of deposits before 1920, investments increased steadily till in more recent years, they have tended to be in the neighbourhood of 30 per cent, and even more. Till the onset of the Depression, these investments used to be held almost wholly in Government of India Securities. There-

* Tables XXV and XXVI.

after, the share of Mysore Government loans began to increase till they were a close second to Government of India securities. In the last three or four years, government-guaranteed and miscellaneous securities have also reached an appreciable size—being above 8 per cent. in 1938.

On account of the predominance of loans and advances, however, the investment portfolio of this bank is small in size as compared with those of other banks.

Changes in the size of loans, advances and investments are explained to a certain extent when the cash-ratio of the bank is examined. Till 1922 the cash ratio used to be very high as a rule, generally above 20 per cent. of deposits, in fact. It shows a sensible decline thereafter to as low levels as 11 and 13 per cent. In the year 1938, it has sunk as low as 7 per cent. but in the earlier two or three years the fall was partly compensated by 3 to 5 per cent. of deposits being held with other banks. The bulk of the increase in investments has thus taken place at the expense of cash, a procedure justified somewhat by the rapid growth of saving deposits.

The bank, although well-managed, has had its phases of distrust and the difficulties springing from it. Perhaps, it experienced its most difficult time when the failure of the Alliance Bank of Simla created nervousness and doleful speculations about Indian joint stock banks. Critics claimed to have discovered that a large amount of about 25 lakhs had been lent without adequate security to directors or ex-directors, either personally or through the medium of concerns in which they were directly interested. The shareholders appointed a committee of investigation on 25th July, 1925. The inquiry disclosed that the security behind the loans was more than adequate, that no preferential treatment had been accorded in the matter of rates charged and the loans were being liquidated on due dates.

Including its head office, the bank has at present 18 branches. Almost all of them are in the territories of the Mysore State. The deposits per branch work out at about 14 lakhs on the average.

TABLE XXV The Bank of Mysore. (Dec. 31st. Balance Sheets.)

(Figures in Lakhs.)

	Paid-up Capital.	Reserve.	Total 1+2.	Fixed Deposits.	Savg's Thrift Deposits.	Current and other Deposits + M. Govt. Balances.	Total Deposits 4+5+6.	Total Liabilities. 3+7	Cash Credits and Demand Loans.	Loans.	Bills discounted and purchased.	Land and Bldgs.	Cash in hand and at Banks in Mysore Treasuries.	Mysore State Loans.	Govt. of India Securities.	Other Govt. Guaranteed and Miscellaneou & Securities.	Total Investment 14+15+16.	Fixed Deposits with other Banks +T. Bs.	Gross profits. 000s.	Net profits. 000s.	Salaries. 000s.
1913	5.9	...	6.	.58	.14	7.6+2.95	4.38	10.44	3.89		1.2	...	3.9	...	...	...	...	1.2	9	3	4
1914	10	...	10	10	.50	3.0+8.7	22.6	32.6	17.5		2.9	...	10.0	.02	.22	...	...	2.5	69	45	11
1915	10	.5	10	19	.62	8.2+10	38	48	27		3.9	...	16	.37	.57	...	...	...	98	71	14
1916	10	1.2	11	28	1.0	11+10	50	60	43		4.8	...	18	.38	.49	...	...	...	125	91	18
1917	10	2.2	12	33	0.9	17+10	61	73	47		4.6	...	15	.49	2	...	2.7	1.0+8.9	124	87	21
1918	10	3.5	13	45	1.1	25+11	83	96	58		2.9	...	24	.76	4.2	...	4.96	6.6+	166	115	27
1919	10	5	15	59	1	35+11	106	121	70		2.5	...	26	.84	6.8	...	7.6	14.7+	183	120	34
1920	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1921	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1922	...	9	...	87	1	62+10	161	...	84		3.6	...	39	6.8	31	...	38	7	376	254	79
1923	...	10.5	...	100	1	40	142	...	109		4	...	18	4.6	36	...	40	...	302	188	86
1924	...	11	...	94	1.8	38+5	139	...	109		6.2	...	17	4.3	32	0.14	36	...	318	188	89
1925	...	11	...	87	2.3	44+5	139	...	105		6.3	4.9	26	3	18	0.15	21	10	317	186	96
1926	...	11	...	95	2.9	42+5	145	...	117		6.9	4.9	18	1	30	1.2	32	...	338	220	88
1927	...	12	...	124	5	45+5	180	...	129		9.1	4.2	17	3	43	2.1	48	9	726	421	182
1928	...	14	...	140	6	52+5	204	...	49 +	95	5.5	4.0	23	4	57	1.7	63	...	779	472	202
1929	...	15	...	129	8	51+5	194	...	50 +	106	9.4	3.9	24	4	33	1.6	39	...	751	481	219
1930	...	16	...	125	8	92+5	231	...	52 +	108	5.9	3.6	18	16	42	1.9	60	0+27	819	462	228
1931	...	16	...	111	10	77	199	...	48 +	91	1.5	4.0	22	15	52	1.6	69	...	780	427	236
1932	...	17	...	129	12	76	218	...	50 +	77	5.5	3.8	27	15	77	1.6	96	2+0	764	424	238
1933	...	19	...	103	14	76	193	...	48 +	89	4.6	3.4	28	15	46	3.1	65	...	806	444	253
1934	...	22	...	102	16	75	193	...	48 +	89?	5.2	3.1	26	24	42	1.2	68	...	858	489	253
1935	...	23	...	111	20	82	213	...	52 +	19	10.5	3.1	44	18	35	.8	61	7+0	920	510	268
1936	...	24	...	122	23	87	233	...	53 +	110	7.1	4.3	29	27	35	.9	87	23+0	878	452	289
1937	...	25	...	122	28	105	256	...	62 +	102	12.1	4.2	34	25	38	16	91	11+0	862	454	255
1938	...	26	...	107	35	105	247	...	62 +	118	10.1	4.6	17	30	38	22	91	...	887	439	255
1939	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1940	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...

TABLE XXVI

The Bank of Mysore

(Percentage of Deposits)

	Capital and Reserve.	Fixed Deposits	Thrift Deposits.	Cash Credit and Demand Loans.	Loans.	Bills discounted & Purchased	Building	Mysore State Loan.	Govt. of India Securities	Other Govt. and miscellaneous Securities	Total Investment.	Cash in hand at Bank & at Treasury	Deposits with other Banks	Treasury Bills.
1912	...	...	...		......	...	...	...	...	...	...	...	...	...
1913	186.9	...	3.2		97.2	27.9	...	...	...	...	...	90.6	27.8	...
1914	44.2	44.2	2.2		77.4	12.8	...	...	1.0	...	1.0	45.4	11.4	...
1915	26.3	50.0	1.6		71.0	10.2	...	0.9	1.5	...	2.4	42.1	...	...
1916	22.0	56.0	2.0		86.0	9.6	...	0.7	0.7	...	1.4	26.0	...	...
1917	19.6	54.1	1.4		77.0	7.5	...	0.8	3.2	...	4.0	24.5	1.6	6.3
1918	15.6	54.2	1.3		69.8	3.5	...	0.9	5.0	...	5.9	28.9	7.9	...
1919	14.1	55.6	0.9		66.0	2.3	...	0.8	6.4	...	7.2	24.5	13.8	...
1920	...	...	...		......	...	...	...	...	...	...	...	...	...
1921	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1922	...	54.0	0.6		52.1	2.2	...	4.2	19.2	...	23.4	24.2	4.8	...
1923	...	70.4	0.7		76.9	2.8	...	3.2	25.3	...	28.5	12.6	...	...
1924	...	67.6	1.2		78.4	4.4	...	3.1	23.0	0.1	26.2	12.2	...	...
1925	...	62.5	1.6		75.5	4.5	3.5	2.1	12.9	0.1	15.1	18.7	7.2	...
1926	...	65.5	2.0		80.6	4.7	3.3	0.7	20.6	0.7	21.4	12.4	...	...
1927	...	68.3	2.7		71.6	5.0	2.3	1.6	23.3	1.1	26.5	9.4	5.0	...
1928	...	68.6	2.9	24.0	46.5	2.7	6.9	1.9	27.9	0.8	30.6	11.2	...	...
1929	...	66.4	4.1	25.7	54.5	4.8	2.0	2.0	16.5	0.8	19.3	12.3	...	...
1930	...	54.1	3.4	22.5	44.5	2.5	1.5	6.9	18.1	0.8	25.8	7.8	...	11.6
1931	...	55.7	5.0	24.1	45.7	0.7	2.0	7.5	26.1	0.8	34.4	11.0	...	...
1932	...	50.1	5.7	22.9	35.3	2.5	1.7	6.8	35.3	0.7	42.8	12.3	0.9	...
1933	...	53.3	7.2	24.8	46.1	2.4	1.1	7.7	23.8	0.6	33.1	14.5	...	...
1934	...	52.8	8.2	...	...	2.7	1.6	12.4	21.7	0.6	34.7	18.4	...	...
1935	...	52.1	9.3	24.4	42.7	4.9	1.4	8.4	16.4	0.4	25.2	20.6	3.2	...
1936	...	52.3	9.8	22.7	43.3	3.0	1.8	11.5	15.0	0.4	26.9	12.4	9.8	...
1937	...	47.6	10.9	24.2	39.2	4.7	1.6	9.7	14.8	6.2	30.7	13.2	4.3	...
1938	...	48.3	14.1	25.1	45.7	4.0	1.8	12.1	15.4	8.9	36.4	6.9	...	...

The Indian Bank*

The Indian Bank established in 1907 is at present the largest of South Indian banks.

Its progress in the earlier years was slow—a fact indictive largely of smaller banking potentialities of South India. In 1908, its paid-up capital was about 10 lakhs and its deposits a little more than 8 lakhs. By the crisis of 1913-14, it had succeeded in building up a reserve of 1½ lakhs and accumulated deposits of more than 30 lakhs. The sponsors of the bank were singularly fortunate in that the 1913-14 crisis did not penetrate into South India and they could say with justification that bank failures "have not affected us."

It was not till 1925 that the deposits of the bank passed 1 crore. By 1932, they were in the neighbourhood of 2 crores and by 1938, they approached 3½ crores.

Much of this recent increase in resources has to be ascribed to vigorous extension of branches. Till 1935, branches numbered only 6 which gave an average volume of resources per branch of about 20 lakhs of rupees. The number increased to 15 in 1930, 26 in 1936, 33 in 1937 and 40 in 1938. The average resources per office fell to about 9 lakhs in 1938. This extraordinary extension of branches was the outcome of unusual banking conditions in the South which ultimately ended in the banking crisis of South India centering round the collapse of the Travancore National and Quilon Bank.†

With increase in resources, the bank adopted a prudent policy of adding to its reserve. Its capital was increased slightly to about 12½ lakhs in 1930 and about 13 lakhs in 1938 but its reserve was augmented much faster and caught it up by 1935. Only 4 lakhs in 1920, it was raised to 10 lakhs in 1930 and is still maintained at that figure. The

* Tables XXVII and XXVIII.

† P. 299.

1908	1 branch	1926	4 branch
1914	1 "	1927	2 "
1916	1 "	1929	2 "
1919	1 "	1931	1 "
1920	1	1932	1 "

Total 15

ratio of capital and reserve to deposits has nevertheless steadily fallen from well above 20 to 25 per cent. prior to 1920 to about 10 per cent. by 1935 and less than 8 per cent. in subsequent years.

Its loans, advances and bills which are not separately stated amounted usually to more than 100 per cent. of deposits till 1925 and before the crisis of 1929-30 ranged above 80 per cent. After a great shrinkage to less than 40 per cent., they have recovered recently to about 65 to 70 per cent. The figures for the last few years show that the proportion of bills in the aggregate of loans, advances and bills has been quite high, about 1/7th to 1/4th of the total.

Its investments which are composed almost entirely of government securities were below 5 per cent. till 1920 and have only risen after 1925 to 15, 20 and 25 per cent. of deposits. In the last few years, the bank has shown some inclination to pay attention to Native State loans and shares of joint stock companies.

The cash ratio of the bank has been always impressive, standing always above 15 per cent. and sometimes in the neighbourhood of 20 per cent.

It would be strange if banking institutions in the South stood above other institutions in being free from communal influences. As a matter of fact, the infection is too all pervasive for a bank to escape it. The following extract from the speech of the bank chairman proves how great is the need of vigilance on this point. "There seems to be an impression in some quarters that the Nattukottai Chetties are unduly favoured by this Bank in the matter of loans. In the sense that a much larger amount is lent to them than to non-Nattikottai Chetties, it may be true to some extent. . . . The bank has sustained no loss by reason of loans to the Nattukottai Chetties, but on the other hand, all the comparatively little loss it has sustained (is) by reason of loans made to non-Nattukottai Chetties . . . if Nattukottai Chetties are not to be encour-

aged to the extent they are, our money is likely to lie locked up."

The particular impression dealt with by the Chairman was most probably without any substance. But recent events connected with the failure of the Travancore National & Quilon Bank prove that there cannot be over-cautiousness on this head. The facts so far as they can be ascertained seem to be these. The shares of the Indian Bank are held largely by the Nattukottai Chetties who are consequently in a strong position to mould the policy of the bank. They may have made use of their power as alleged to secure advances to their own community members on the basis of mere two name paper. In certain years, these advances on personal credit have been almost as large as the deposits of the bank while advances against goods and for trade purposes have been only a fraction, from about 1/13th to 1/10th of advances. The Chetti firms themselves engage almost exclusively in banking and not in trade. In other words, the funds of the bank are not available directly for trade of the country but only indirectly through the lending operations of the Chetties. What gives a tinge of bitterness to the complaints is the fact that the deposits of the bank are not drawn in any appreciable measure from the Chetties who have other outlets for their money but from other classes and communities, salary-earners and wage-earners. The bank prefers the security of the Chetty intermediary to that of goods or other assets and earns perhaps a higher rate of interest. This should explain why the Indian Bank avoids investments and holds such a large proportion of funds in loans, advances and bills.*

The Indian Bank carries on its business in the special circumstances of South India. These might be described in one phrase as paucity of bankable resources. In spite of this paucity, moderation has been the keynote of rates which the Indian Bank offers on its deposits. Till the onset of the Great Depression, the average rate paid by it on time and demand deposits tended to be next to those

* Commerce, July 25th 1925 and July 18th 1925.

paid by respectable banks in the Punjab and the U. P. In the twenties and till 1931, rates from 3½ to 4 per cent. were the general rule. Since the Depression, the rates of the Indian Bank are exceeded by the Allahabad Bank of India and the Punjab National Bank only.

Moderate as its deposit rates are, the requirements of capital in the South exceed supplies by such a margin that the returns on funds invested are the highest among those of which we have record. The earnings of the Indian Bank per cent. of resources employed represent, as pointed out above, only the minimum average charges paid by its clientele. When we take account of the intermediary services of the Chetties, the cost of finance to the public must turn out very much higher than this minimum. Yet, the rate of earning of the Indian Bank was perhaps the highest among the Big Seven till 1925 and now after the Punjab National Bank, it is the next best rate earned among the Big Seven. Till 1931, the earning rate was commonly above 6½ per cent. After 1931, the rate has been rarely below 4 per cent. Perhaps, the predominance of coffee, rubber and other agricultural interests in the clientele of the bank partly explains the high level of these rates.

The margin between the average rate paid on deposits and the rate earned on assets is apt to be as wide as 2½ to 3 per cent. and even more and the rate of gross profits has been always the highest among big banks and only recently after 1925, has become inferior to that of the Imperial Bank. The latter has rarely fallen below 3 per cent.

The advantage of the highest rate of gross profits was much reduced by the fact that till 1925 the expense ratio was also the highest among those banks of which we have any record. This could not be due to any special expensiveness of carrying on banking business in South India. Clerical labour is notoriously cheap in those parts of the country. Yet, the fraction of gross profits paid as salaries which was about 20 to 25 per cent. before the close of

the Great War has mounted to 30 per cent. since. A fraction of 25 to 30 percent. holds good for some of the most highly staffed and expensively managed banks in this country like the Bank of Baroda, Bank of India, etc. After 1925, its expense ratio is showing itself to advantage as compared with those of the Imperial Bank and the Allahabad Bank of India.

The explanation of this high expense ratio and particularly the recent increase in the proportion of expenses to gross profits lies in the extension of branches and the small volume of resources per branch. With 26 branches in 1936, the resources per branch were Rs. 12 lakhs only. With 40 branches in 1938, the resources per office dwindled to 9 lakhs. The Allahabad Bank which stands immediately above it in point of resources per office or branch has an average of 20 lakhs. It is hardly surprising in these circumstances that the Indian Bank is one of the most expensive to run among the big Indian banks. That its fraction of expenses to gross profits is not higher than those of some other banks in the country is understandable only on the assumption of poor salaries paid to employees.

In spite of its high expense ratio, however, its rate of net profit was the highest among leading banks till the Depression year 1935-38. It redounds to the credit of the management that ever since the Great War, it has used a large part of the net profits to add to the reserves. Only 3 lakhs in 1918, the reserve improved to 6 lakhs in 1923, 9 lakhs in 1929 and 13 lakhs in 1935. Today the paid-up capital and reserve are equal, although their ratio to deposits has fallen rather low.

The dividend declared in 1908 was only 4 per cent. and was raised gradually to 7½ per cent. till 1920. By 1927, it had reached 12 per cent. and with an occasional increase in a year or two, it has been maintained at that figure. The sum diverted to dividends has been about a half of net profits, which is not excessive according to the usual policies of banks in India.

TABLE XXVII The Indian Bank. (Dec. 31st.)

(Figures in Lakhs.)

	Paid-up Capital.	Reserve Investment and Contingency.	Total 1+2.	Fixed, Current, Savings cash certificates etc.	Total Liabilities.	Loans Overdrafts Bills Pro. note.	Bills	Bldgs.	Govt. Securities at cost price.	Loans of Native State.	State Savings Bank account.	Fully paid shares of Reserve Bank & Jt.-Stock Co.	Immovable Properties.	Total Investments 9+10+11+12+13.	Treasury Bills	Short Notice Deposits at Banks.	Cash on hand and at Bank.	Total Eranings 000s.	Interest to Depositors. 000s.	Gross profits. 000s.	Net Profits 000s.	Salaries 000s.	Total expense 000s.
1908	9.8	0.12	10	8	19	...	...	...	...	...	...	...	...	...	...	...	...	...	...	100	5	...	...
1909	10.0	0.27	10	...	24	...	...	...	...	...	...	...	...	...	...	...	...	...	...	140	64	...	...
1910	10	0.27	10.3	21	33	28		1.3	0.9	...	...	...	...	...	...	...	1.4	188	70	118	74	21	35
1911	10	0.50	10.5	23	34	27		1.5	1.1	...	...	...	...	...	...	...	4.4	228	91	137	83	26	45
1912	10	0.75	10.7	28	38	29		1.5	0.9	...	...	...	...	...	...	...	7.2	245	98	147	92	31	51
1913	10	1	11	24	35	30		1.4	0.9	...	...	...	...	...	...	...	4.0	304	114	190	96	32	51
1914	10	1.5	11.5	19	31	23		1.4	0.9	...	...	...	...	...	...	...	6.0	246	91	145	139	34	46
1915	10	1.7	11.7	24.3	36	27.8		1.3	0.9	...	...	...	...	...	...	...	6.8	218	88	130	99	34	55
1916	10	2.0	12.0	32.3	44	33.9		1.8	2.0	...	...	...	...	...	...	...	8.1	292	100	192	75	37	61
1917	10	2.5	12.5	41.1	53	40.9		1.3	2.0	...	...	...	...	...	...	...	10.5	341	136	205	131	39	69
1918	10	3	13	42	55	35		1.2	2.0	...	...	...	...	...	...	...	17.0	376	164	212	136	40	84
1919	10	3.5	13.5	58.2	71.7	56.7		1.2	2.4	...	...	...	...	...	...	...	12.4	420	188	232	128	56	98
1920	10	4.0	14.0	52.2	72.2	56.3		1.2	2.5	...	...	...	...	...	...	...	13.6	545	227	318	139	74	120
1921	12.5	5.0	17.5	76.4	93.9	80.0		1.2	5.0	...	...	...	...	...	...	...	8.8	615	287	328	198	98	168
1922	12.7	5.5	18.2	63.3	81.5	68.6		1.2	5.0	...	...	...	...	...	...	...	7.9	643	261	382	160	106	173
1923	12.7	6.2	18	68	86	73		1.1	5.0	...	...	...	...	...	...	...	7.8	651	254	397	209	119	193
1924	12.7	6.2	18.9	75.5	94.4	96		1.1	5.0	...	...	...	...	...	...	...	6.2	754	316	487	204	118	196
1925	12.7	7	20	99	119	85		1.0	16.0	...	...	...	...	...	...	...	16.0	780	398	362	242	123	107
1926	12.7	7	20	113	133	83		1.0	26.0	...	...	...	...	...	...	...	22.0	773	447	326	175	129	200
1927	12.7	7	20	144	164	127		1.0	22.0	...	...	...	...	...	...	...	12.0	941	475	466	126	149	253
1928	12.7	7	20	158	178	136		1.0	16.0	...	...	...	...	...	...	...	26.0	1186	568	618	213	151	248
1929	12.7	9	22	186	208	125		1.0	31.0	...	...	...	...	...	...	14	38.0	1355	657	698	370	156	303
1930	12.7	10	22	192	214	114		1.0	46.0	...	...	...	...	...	...	21	33.0	1354	700	654	395	166	354
1931	12.7	11	23	173	195	103		0.8	46.0	...	...	...	...	...	15	8	22.0	1287	685	692	300	179	356
1932	12.8	12	25	199	224	71		0.8	78.7	...	...	...	...	...	15	10	47.0	1219	641	578	246	169	385
1933	12.8	12	25	226	251	101		0.8	92.8	...	1.5	...	0.5	...	10	...	44.0	1407	643	764	193	179	357
1934	12.8	12.0	25.8	220	245.8	138		0.8	71	...	...	...	...	...	...	3.2	...	1386	546	840	427	186	413
1935	12.8	13	26	262	288	133		1.0	46.4	...	8	5	...	...	21	...	58	1175	550	625	258	204	367
1936	12	16	28	296	344	167	40	1.0	...	...	...	...	...	70	...	...	64	1290	631	659	239	247	420
1937	12.7	13	26	330	356	169	52	1.9	62	9	3	3	...	77	62	...	63	1344	625	719	242	287	477
1938	12.7	13	26	336	362	182	30	1.8	68	6	...	5	...	79	68	...	53	1535	683	852	285	326	567
1939	12.7	14	26.7	385.6	412	256	...	1.8	75	5	0	3	...	91	...	39	55	1738	1436	1119	317	388	...
1940																							

TABLE XXVIII
The Indian Bank

(Percentage to Deposits. Dec. 31st)

	Capital and Reserve.	Loans Overdrafts Bills Promotes.	Buildings.	Govt. of India Securities.	Loans of Native States.	State Savings Bank Accounts.	Shares of Reserve Bank and Jt.-Stock Cos.	Total Investments.	Short Notice Deposits at Bank.	Cash on hand and at Bank.
1908	125.0	...	...	...	...	...	...	...	...	...
1909	...	...	...	...	...	...	...	...	...	...
1910	49.0	183.3	6.2	4.3	...	...	...	4.3	...	6.6
1911	45.6	117.3	6.5	4.4	...	...	...	4.4	...	19.1
1912	88.2	103.5	5.3	3.2	...	...	...	3.2	...	25.7
1913	45.8	185.0	5.8	3.7	...	...	...	3.7	...	16.6
1914	60.5	121.0	7.3	4.7	...	...	...	4.7	...	31.6
1915	42.0	114.4	5.3	3.7	...	...	...	3.7	...	27.9
1916	37.1	104.9	4.0	6.5	...	...	...	6.1	...	25.0
1917	30.4	99.5	3.1	4.8	...	...	...	4.8	...	25.5
1918	25.0	85.7	2.8	4.7	...	...	...	4.7	...	40.4
1919	28.1	97.4	2.0	4.1	...	...	...	4.1	...	21.3
1920	24.0	96.7	2.0	4.2	...	...	...	4.2	...	23.3
1921	22.9	104.7	1.5	6.6	...	...	...	6.6	...	10.8
1922	28.7	108.3	1.8	8.3	...	...	...	8.3	...	12.4
1923	27.5	126.8	1.6	7.3	...	...	...	7.3	...	10.3
1924	25.0	127.1	1.4	6.6	...	...	...	6.6	...	8.2
1925	19.8	85.8	1.0	16.1	...	...	...	16.1	...	16.1
1926	17.5	73.4	0.7	23.0	...	...	...	23.0	...	19.4
1927	13.6	88.1	0.7	15.2	...	...	...	15.2	...	8.3
1928	12.4	86.0	0.6	10.1	...	...	...	10.1	...	16.4
1929	11.6	67.2	0.5	16.6	...	...	...	16.6	7.5	20.4
1930	10.2	59.3	0.1	23.9	...	...	...	23.9	10.9	17.1
1931	13.7	59.8	...	26.7	...	...	...	26.7	4.6	12.7
1932	12.4	35.8	...	39.5	...	...	...	30.5	5.0	23.6
1933	10.9	44.6	...	41.0	...	...	...	41.0	...	19.4
1934	11.7	62.7	0.3	...	...	...	...	32.3	...	32.7
1935	9.3	50.7	0.4	1.7	...	...	...	17.7	...	28.1
1936	9.4	69.4	...	...	...	...	...	23.4	...	21.4
1937	7.7	66.9	0.5	18.7	2.7	0.9	0.9	23.2	...	19.0
1938	7.6	63.3	0.5	20.2	1.7	...	1.4	26.3	...	16.0
1939	6.9	66.5	0.4	18.7	1.3	...	0.7	23.6	...	19.2

The Union Bank of India*

The Union Bank of India was started very recently in 1919. Its paid-up capital was impressively large—being 40 lakhs and recently the bank has built up a reserve of 7 lakhs. In spite of its own large funds, its acquisition of deposits has been rather slow—indicating either that the banking potentialities of Bombay City are already well exploited or the Union Bank has confined its activities to those classes which are already well served by pre-existing banks. By 1929, the deposits of the bank passed half a crore. The Depression caused the bank a sensible setback but it recovered lost ground by 1934 and by 1937, the deposits were well above 1 crore.

In consequence of foregoing facts, the ratio of capital and reserve stood as high as 150 per cent. and more for the greater part of the bank's existence and even now, it exceeds 40 per cent.

Its loan and advances have been 40 to 50 per cent. of deposits in recent years and its investments have been 70 per cent. and more. It is remarkable that ordinary shares of joint stock companies account for about ¼th of the investment portfolio. The cash ratio is more often than not above 20 per cent.

It is clear that the bank is still in its initial stages and the balance sheet still bears the mark of immature conditions.

* Tables XXIX and XXX.

TABLE XXIX The Union Bank of India. (March 31st.)

Figures in Lakhs

	Paid-up Capital.	Reserve Funds.	Total 1+2.	Fixed and Savings.	Current Deposits	Total Deposits.	Total Liabilities	Govt. Giltedge Securities.	Pref. & Debenture of Jt. Stock Cos.	Ord. Shares of Jt.-Stock Cos.	Total Investments	Cash Credits & Demand Advances.	Loans	Bills dis. & Purchased.	Bank Premise.	Cash money at call and short notice.	Total earnings. 000s	Interest Pd. to Deps. 000s.	Gross Profits 000s.	Net Profits 000s	Salaries. 000s.
1925	...	...	...	...		...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1926	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1927	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1928	40	6	46	...	...	51	97	...	...	...	40	8	30	13	...	9	...	...	458	291	98
1929	40	6	46	...	...	32	78	...	...	...	28	9	24	10	4.3	8	...	...	395	270	83
1930	40	6	46	...	...	27	73	...	...	...	21	8	34	3	4.1	7	...	...	353	234	80
1931	40	7	47	...	...	27	74	...	...	...	40	8	19	0.6	4.0	6	...	...	341	234	73
1932	40	7	47	...	...	28	75	...	...	...	40	10	18	0.5	3.9	5	...	...	324	216	75
1933	40	7	47	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1934	40	7	47	...	...	51	98	...	...	...	55	9	16	5.0	3.7	10	...	...	369	227	99
1935	40	7	47	...	...	66	113	...	...	...	56	23	17	...	3.7	15	...	...	408	260	107
1936	40	7	47	...	...	99	146	39	...	19	58	23	17	12	3.5	29	...	...	421	262	116
1937	40	7	47	...	...	104	151	34	21	18	73	44		11	3.4	22	700	234	466	265	94
1938	40	7	47	...	...	106	153	28	25	19	73	49		14	3.3	17	678	171	502	303	91
Dec. 1939	40	3.2	48	...	...	144	142	47	10	22	80	89		6	3.1	21	...	...	...	...	...
Bank of Behar.																					
1911	0.7	...	0.7	...	...	.06	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1913	0.36	0.03	0.39	...	...	5.48	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1915	0.65	0.21	0.86	...	...	7.81	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1917	1.07	0.32	1.39	...	...	8.11	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1919	1.30	0.74	2.04	...	...	12.21	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1920	1.55	0.85	2.40	...	...	13.03	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1933	3.3	1.5	5.0	...	...	52	57	0.9	0.8		2.7	42		...	1.2	8.7	...	...	...	...	...
1935	3.3	2.3	6.0	...	...	74	80	2.9	......		5.6	54		...	1	17(incl drafts)	...	...	...	...	...
1938	9	4	13	...	...	120	133	8	3		...	92		...	1	26,,	...	...	...	...	...
Bank of Hindustan. (Dec. 31st.)																					
1937	10	0.40	10	...	...	47	57	4.5	...	...	...	43		...	...	9.6	299	106	193	57	...
1938	10	0.50	10	...	...	22	37	4.5	...	...	...	23		...	...	5.3	298	103	190	32	...

TABLE XXX (Percentage to Deposits.)

The Union Bank of India.

	Paid-up Capital and Reserve	Fixed Deposits.	Cash, Credits and Demand Advances.	Loans.	Bills.	Govt. Securities.	Preference Shares and Debentures of Jt.-Stock Cos.	Ordinary Shares of Jt.-Stock Cos.	Total Invest-ment	Cash call and Short notice money.
1925	...	...	...	...	...	...	...	...	...	...
1926	...	...	...	...	...	...	...	...	...	...
1927	...	...	...	...	...	...	...	...	...	...
1928	110.8	...	15.6	65.2	...	...	...	...	86.9	13.0
1929	143.7	...	29.9	75.0	31.2	...	...	...	87.5	25.0
1930	170.0	...	29.6	125.9	125.9	...	...	...	77.7	25.9
1931	170.0	...	29.6	70.3	2.2	...	...	...	148.0	22.2
1932	167.8	...	35.7	64.2	1.7	...	...	...	142.8	17.8
1933	...	...	...	...	...	...	...	...	...	...
1934	92.1	...	17.6	31.3	9.8	...	...	...	107.8	19.6
1935	71.2	...	34.8	25.7	...	...	...	...	84.8	22.7
1936	47.4	...	23.2	17.1	12.1	39.8	...	19.1	58.5	29.2
1937	45.1	...	42.3		10.5	32.6	20.1	17.3	70.0	22.6
1938	40.5	...	46.2		13.2	26.4	23.5	17.9	67.8	16.0
1939										
1940										

The Bank of Hindusthan.

	Paid-up Capital and Reserve	Fixed Deposits.	Cash, Credits and Demand Advances.	Loans.	Bills.	Govt. Securities.	Preference Shares and Debentures of Jt.-Stock Cos.	Ordinary Shares of Jt.-Stock Cos.	Total Invest-ment	Cash call and Short notice money.
1937	221.0	...	91.4		...	9.5	...	...	...	20.4
1938	47.0	...	109.0		...	20.4	...	...	...	24.0

The Bank of Behar*

Judged by its long life, the Bank of Behar is one of the senior banks in the country, its year of establishment being 1911.

It had a very modest, almost obscure beginning. In 1911, its paid-up capital was only a meagre Rs. 7000, as against authorised and subscribed capital of 10 lakhs and 2½ lakhs respectively. By 1913, the bank created a reserve of 3000. The deposit liabilities against these slender owned resources amounted to 6 thousand only.

In its earlier stages at least, the bank engaged in fire and life insurance business as well.

Its paid-up capital was raised very slowly, to 36 thousand in 1913, a little over a lakh in 1917 and 1½ lakh in 1920. The reserve in these years amounted to 3, 32 and 85 thousand only. It attracted a respectable volume of deposits, 5 lakhs and over in 1913, 8 lakhs in 1917 and more than 13 lakhs in 1920.

Thereafter, steps were taken to expand the capital structure of the bank. In 1938, the capital exceeded 13 lakhs and deposits stood at 120 lakhs.

The ratio of capital and reserve to deposits has been in the neighbourhood of 10 per cent. in recent years. Its investments are rather slender, about 5 to 10 per cent. of deposits only. The bulk of its deposits from 70 to 80 per cent. in fact is placed in loans and advances. The bank maintains a high cash ratio—20 per cent. and more.

† Tables XXIX and XXX.

TABLE XXXI

The Bank of Behar (Dec. 31st)

(Figures in thousands)

	Paid-up Capital.	Reserve	Total	Fixed Deposit.	Current Deposit.	Total Deposits.	Total Liabilities.	Cash.	Bills.	Bills, Cash Credit demand Adv. & Loans.	Loans.	Govt. Securities.	Debentures of Jt. St. Cos.	Preference and ord. shares.	Total Investment.
1911 ...	14	...	14	...	...	146	160	5	...	...	...	...	...	...	...
1912 ...	20	...	20	...	...	377	397	37	...	346	...	...	2	...	2
1913 ...	36	3	39	...	...	549	588	107	...	405	...	22	2	...	24
1914 ...	43	10	53	...	...	695	748	135	...	530	...	13	2	...	15
1915 ...	65	21	86	...	...	781	867	188	...	631	...	16	2	...	18
1916 ...	93	26	119	...	...	973	1092	289	...	766	...	14	...	25	39
1917 ...	107	32	139	...	...	811	950	147	...	758	...	7	...	16	23
1918 ...	113	50	163	...	...	956	1119	195	...	876	...	13	...	18	31
1919 ...	130	70	200	...	...	1221	1421	416	...	864	...	51	...	36	87
1920 ...	175	88	263	...	...	1348	1611	398	...	1097	...	48	...	37	85
1921 ...	220	121	341	...	...	1927	2268	415	...	1744	...	47	...	33	80
1922 ...	247	136	383	...	...	2169	2552	616	...	1759	...	40	...	30	70
1923 ...	279	158	437	...	...	2046	2483	254	...	2135	...	40	...	26	66
1924 ...	301	170	471	...	...	1749	2220	251	...	1874	...	42	...	27	69
1925 ...	306	170	476	...	...	2082	2558	246	...	1994	...	55	...	23	78
1926 ...	308	170	478	...	...	2379	2857	364	...	2297	...	62	...	30	92
1927 ...	309	126	435	...	...	2045	2480	644	...	2478	...	144	...	28	172
1928 ...	312	126	438	...	...	3178	3616	678	...	2451	...	201	...	36	237
1929 ...	319	126	445	...	...	3418	3863	464	...	2744	...	190	...	59	249
1930 ...	332	126	458	...	...	3954	4412	541	...	3060	...	357	...	60	435
1931 ...	340	127	467	...	...	3891	4358	451	...	3377	...	147	...	59	206
1932 ...	346	155	501	...	...	4610	5111	891	...	3392	...	289	...	79	368
1933 ...	362	173	535	...	...	5666	6201	886	...	4543	...	477	...	77	554
1934 ...	374	235	609	...	...	6693	7302	891	...	5309	...	483	...	46	529
1935 ...	510	280	790	...	...	8135	8925	1456	...	6398	...	678	...	145	823
1936 ...	571	360	931	...	...	9881	10812	2871	...	6905	...	820	...	113	933
1937 ...	846	400	1246	...	...	10799	12045	2584	...	7936	...	1054	...	305	1359
1938 ...	909	460	1369	...	...	11989	13358	2635	...	9228	...	1050	...	310	1360
1939 ...	1002	533	1535	...	...	11986	12521	2109	...	9652	...	1046	...	362	1408

TABLE XXXII

The Bank of Behar

(Percentage to Deposits)

	Paid-up Capital and Reserve.	Demand Advances, Cash Credits, Loans and Bills.	Government Securities	Debentures of Jt.-Stock Cos.	Preference and ord. Shares.	Total Investments.	Cash.
1911 ...	9.5	...	...	...	...	...	3.4
1912 ...	5.3	91.7	...	0.5	...	0.5	9.8
1913 ...	7.1	73.7	4.0	0,3	...	4.3	19.4
1914 ...	7.6	76.2	1.8	0.3	...	2.1	19.4
1915 ...	11.1	80.7	2.0	0.2	...	2.2	24.0
1916 ...	12.2	78.7	1.4	...	2.5	3.9	29.0
1917 ...	17.1	93.4	0.7	...	1.9	2.6	18.1
1918 ...	17.0	91.6	1.3	...	1.8	3.1	20.0
1919 ...	16.3	70.7	4.1	...	2.9	7.0	34.0
1920 ...	19.5	81.3	3.5	...	2.7	6.2	29.5
1921 ...	17.6	90.5	2.4	...	1.7	4.1	21.5
1922 ...	17.5	81.1	1.8	...	1.3	3.1	23.4
1923 ...	21.3	104.3	1.9	...	1.2	3.1	12.4
1924 ...	26.9	107.1	2.4	...	1.5	3.9	14.3
1925 ...	22.8	95.7	2.6	...	1.1	3.7	16.6
1926 ...	20.0	96.5	2.6	...	1.2	3.8	15.3
1927 ...	21.2	121.1	7.0	...	1.3	8.3	31.4
1928 ...	13.7	77.1	6.3	...	1.1	7.4	21.3
1929 ...	13.0	80.3	5.5	...	1.7	7.2	13.5
1930 ...	11.5	77.3	9.4	...	1.5	10.9	18.6
1931 ...	12.0	86.7	3.7	...	1.5	5.2	11.6
1932 ...	10.8	73.5	6.2	...	1.7	7.9	19.3
1933 ...	9.4	80.1	8.4	...	1.3	9.7	15.6
1934 ...	9.1	79.3	7.2	...	0.6	7.8	13.3
1935 ...	9.7	73.5	8.3	...	1.7	10.0	17.9
1936 ...	9.4	69.8	8.3	...	1.1	9.4	20.0
1937 ...	11.5	73.4	9.7	...	2.8	12.5	23.9
1938 ...	11.4	76.9	8.7	...	2.5	11.2	21.9
1939 ...	12.8	80.5	8.7	...	3.0	11.7	17.6
1940 ...	...	...	...	...	...	...	...

CHAPTER VII

ECONOMY AND EFFICIENCY OF INDIAN BANKS*

THE gross profits of a bank are the difference between its total earnings† and the interest it pays its depositors. In other words, gross profits represent the cost which the public has to bear for the services of banks as intermediaries. Changes in gross profits may occur either because earning and deposit rates are not accurately adjusted to each other or because the costs of banking business have altered. Maladjustments between earning and deposit rates can be only temporary and therefore are not relevant factors in long period changes. Under competitive conditions, long period movements in gross profits are as a rule the expression of changes in costs of banking business.

Gross profits are best expressed as a percentage of aggregate resources, capital, reserve and deposits which are employed in earning them.‡

Among big Indian joint stock banks, the highest rate of gross profits is earned by the Imperial Bank of India. Till the Depression cut into its profits appreciably about 1931 and the statutary changes of 1935 deprived it of a portion of interest-free funds, the rate rarely fell below 3·20 and was usually very much higher. Self-evidently, new areas and classes with which the bank was brought into contact through its new statutary branches created very largely between 1921-1926 have not caused any adverse changes in the rates paid on deposits or the lucrativeness of its business. Even after the Depression, the rate continues pretty high, never falling below 2·50. These

* References throughout are to Tables XXXIII and XXXIV.

† Table VII and pp. 69-71.

‡ In all cases, interest, earnings, profits, expenses, etc., are aggregates for the whole year, but to arrive at percentages, have been divided not by the average resources for the year but resources as they stood on 31st December (31 March for Allahabad Bank). In so far as December represents average conditions ,the inaccuracy is mitigated.

rates may be compared with that of a typical big British bank like the Barclays which earned 2·4 per cent in a fairly normal year like 1926.

The lowest rate of gross profits is earned usually by the Bank of Baroda. Except for a sporadic fluctuation in deposits or in gross profits here and there, the Depression seems to have affected this bank but little. Its rate of gross profits has rarely fallen below 1·50 and levels above 1·70 and 1·80 are pretty common, particularly in pre-Depression years.

A close examination of the figures for the leading six banks of India makes it clear that there is no evidence of any tendency to a secular fall in the rate of gross profits. In the case of some of these banks, the onset of the Depression caused some recession in the rate of gross profits but there is more than ample evidence, in recent years, of recovery to accustomed levels.

This evidence of recovery is again very remarkable since in the last few years, Indian joint stock banks have added to their branches in a most striking manner. It will be recalled that in the case of many of them the volume of resources per branch has shown substantial declines. Yet, the tendency of gross profits rate to maintain itself proves that we are far from reaching positively unprofitable classes or areas in the country.

The net profit of a bank is the balance of gross profits over and above the expenses incurred in the management of its business. Changes in net profits over a period of time indicate whether changes in the size of a bank have brought with them economies or diseconomies of management. Net profits of banks relatively to each other throw light on their relative efficiencies of management or organization as well as their special problems and difficulties. Net profits are thus a matter of deep concern both to shareholders and the community at large.

Net profits are again best expressed as a percentage of the aggregate resources, capital, reserve and deposits which

are employed to earn them. The difference between the rates of gross profits and net profits gives us the expense ratio of banks per unit of resources.

The Imperial Bank of India maintains again the highest rate of net profits. Till the Depression produced its effects by 1932, the rate moved well above 1·50 reaching as high as 2·0 in the boom year 1921 and 1·85 in the normal year 1927.

The Bank of Allahabad or the Bank of Baroda tends genenally to show the lowest rate of net profits. The Bank of Baroda, it will be recalled, has the lowest rate of gross profits and its expense ratio shows itself to advantage as compared with many banks in this country. Its low rate of net profits is therefore due to causes which operate on its gross rate and which we have analysed elsewhere.*

The Allahabad Bank reveals a different situation. Its rate of net profits, although low, has been remarkably stable. While it reached levels much above ·80 during the war, it has been generally in the neighbourhood of ·50 and sometimes above it in post-war times.

The Depression makes it difficult to speak about any secular tendencies of net profits. While gross profits fell and recovered, different banks were able to reduce their expenses in different degrees. Most of the banks found their expense ratio actually mounting up while one or two like the Bank of Baroda and the Central Bank succeeded in checking the rise. The Imperial Bank seems to have succeeded most, due probably to its growing Indianisation.

Salaries paid to the staff are at once the most important and unfortunately the most elastic head of a bank's expenditure. They are best expressed as a percentage of the gross profits of a bank, gross profits being the direct source out of which they must be supported. The Barclays Bank showed this fraction for a normal year like 1926 at 49·75, a figure which holds good probably for all the Big Five of England.

* Pp. 212-14.

In India, this fraction varies from about 25 per cent. in the case of the Bank of India to about 52-55 per cent. in the case of the Allahabad Bank. Comparing post-Depression years with those immediately preceding, we do not find an appreciable rise in the fraction. Over the last 25 years or so, however, the fraction shows a secular rise. It is partly due no doubt to the extension of branches but partly it may be due to qualitative improvement in the bank personnels.

The stability of gross profits rates and the secular rise in the expense ratios of banks raise the question whether our banks have expanded beyond the point of maximum profitability. It is not easy to draw definite inferences since the Depression has hit different banks in different degrees. Their ability to reduce their overhead expenses naturally varies. The Punjab National Bank is perhaps the worst sufferer, if only the level of net profits is taken into account. The Allahabad Bank more than maintained its position while the Bank of India, the Central Bank and the Bank of Baroda prevented fall to very low levels. The net profits rate of the Imperial Bank never receded below 1·10 per cent. The tide was generally reversed by 1936 and recovery to pre-Depression levels is now only a question of time.

Taking pre-Depression years, three banks namely the Imperial Bank, the Central Bank of India and the Bank of India showed a rate of net profits well above 1·00 per cent. The Punjab National Bank and the Bank of Baroda record a rate generally above ·80. The Allahabad Bank had and still has a stable rate of about ·50 and more.

Experience of other countries should throw some light on the significance of these differences. The net profits rate of London banks between 1861 and 1913 and the rate for banks in England and Wales between 1874 and 1913 have both declined in a progressive manner. In the latter case, the decline has been from 1·88 per cent. in 1874 to ·57 per cent. in 1923. For Barclays Bank, which may be taken as typical of the Big Five, the rate for 1926 was ·73. There is

no doubt about the causes of this remarkable decline. Their expenditure ratio has mounted up with ruthless consistency, the items of expenditure practically remaining the same. Increased charges have largely occurred under the heads Salaries, Rents, Taxes and Telephone Charges, items all connected with the expansion of branches. In actual figures, the ratio of expenses to working resources mounted up from ·74 in 1861 to ·96 in 1914 for all banks in London.

Per unit of resources employed, there is no doubt that the expenses of banking business are very high in this country. In spite of a progressive deterioation from 1861 to 1914, the expense ratio of British banks was only ·96 per cent. in the latter year. Only two banks in this country, the Bank of India and the Bank of Baroda show a ratio which compares favourably with the British ratio. The example of these two banks, so diverse in the character of the territories served, is sufficient proof that special conditions of India as such cannot explain the difference in the outcome of banking in India and banking in England. The expense ratios of these two banks, which vary between ·75 to ·85 per cent. are superior to that of a typical big bank like the Barclays even. The other big five Indian banks have expense ratios which vary between a wide range of 1·40 to 2·50 per cent. The lower limit is represented by the Central Bank of India and the upper limit by the Indian Bank of Madras.

Comparison with British banks is to an extent unfair to Indian banks since Great Britain represents the most advanced and experienced banking system of the world. The volume of resources per office and consequently, gross profits are so large in Great Britain that even with their much more elaborate organisation and liberal salaries, only a small fraction out of the latter has to be paid out in expenses. In other words, the fraction of gross profits retained as net profits is the highest in the world. It has tended even in recent years to exceed 85 and 90 per cent. when in other countries like Switzerland and the United States 35 to 40 per cent. before the crisis and 25 to 35 per cent. after the crisis have been the rule. Among Indian banks

the fraction has been the lowest for the Allahabad Bank (21 to 25 per cent.) and the Punjab National Bank (10 to 20 per cent.), moderately low for the Central Bank (35 to 40 per cent.) and fairly high for other banks (40 to 50 per cent.). The Bank of India leads with the highest fraction which is generally in the neighbourhood of 55 per cent.

The main factor in the high expense ratios of our banks is indisputably the small volume of resources with which they have to operate. Modern methods of banking presuppose certain elaborate organisation and practices. They prove cheap only when the resources which are to be handled are very large. In India, each step in expansion means as a rule venturing on areas of lower and lower banking potentialities. The outcome is increasing expense ratios.

The resources per branch of the Bank of India are thrice as high as those of the Imperial Bank which ranks next to it on this point. It is inevitable therefore that its expense ratio should be the lowest. Other banks have resources per branch which range from about 45 lakhs in the case of the Imperial Bank of India to a mere 10 lakhs in the case of the Indian Bank of Madras. In regard to their expense ratios, it will be found that their ranking is approximately the same as that which holds for their resources per branch.

It is also true that our banks have yet to develop a technique suitable to the conditions and banking resources of the country. Perhaps, the main weakness lies in the quality of the personnel which our banks recruit. It is to be feared that the wastefulness of cheap labour and the economy of high wages are no more than pious phrases even in the highest business quarters in this country. Everything seems to conspire to put a premium on everything except qualifications and ability. Little has been done to develop any special type of training suitable for the small and distant places in the countryside or the lean outskirts of big places. Premises of Indian banks are apt

to present the appearance, sometimes of a holiday picnic and sometimes of the confusion and disorder of an Indian bazaar.*

Little accurate or systematic thought has been devoted to the planning and execution of bank-organisation. Modern devices are conspicuous by their absence. Little effort is made to distinguish between profitable and unprofitable activities, cost accounting and specific investigations being looked on as dangerous heresies.

The net profits of banks computed as percentages of capital and reserves vary between 9·01 per cent. for the Bank of Baroda to 16.5 per cent. for the Indian Bank. This is indeed remarkable since the ratio of capital and reserves to borrowed resources is much higher than in England and certainly not inferior to those of other countries. The corresponding percentages for England, France, the United State and Switzerland are markedly lower. In other words, the profits available for distribution to shareholders are quite generous in this country.

It has been sometimes alleged that banks in India distribute too large a share of their net profits as dividends with the object of maintaining the value of their shares and creating a spurious kind of confidence in themselves. Such an allegation could not hold true of the more well-known

* On the occasion of the inauguration of the Sydenham College Banking Association in 1924, Mr. A. G. Gray, Manager of the Bank of India observed, inter alia—" The answer is—the extraordinary expense of a branch office in India as compared with that in England and more especially in Scotland.

In Great Britain, the staff of a new branch bank may consist of nothing but a manager and one junior clerk, probably an apprentice, while a small office at Parel (a poor part of Bombay) would require :—

An Agent,
Accountant,
Receiving Cashier,
Paying Cashier,
Two clerks,
and about four sepoys or hamals,

together with an organization at Head Office to replace these men at a moment's notice in case of sickness or ceremonies.

......But the real crux of the matter is that the Indian Bank Official must learn to do his own routine work and not only to sit in an office chair and give orders to clerks and peons; at the same time, I do not suggest that you should blindly imitate British Banking Practice. I would ask you to study the real indigenous banking organization of India i.e. the Shroffing system......"

banks in the country.* In times of exceptionally lean profits like those which succeeded the 1929 crisis, dividends have been maintained by allotting as large a fraction of net profits as 80 to 90 per cent. for the purpose. Such was the policy of the most conservative and well-managed banks even like the Bank of India and the Bank of Baroda. But ordinarily, the fraction rarely exceeds 60 per cent. The share values of these banks follow the course of the stock exchange cycles and give no ground to suspect any undue inflation of values. As in the case of the Allahabad Bank, their affiliations and other wellknown qualities exercise some influence on values over and above the influence of mere relative return. Otherwise, the main evil in this field is the declaration of profits and dividends even though no profits or no adequate profits have been made by new banks or banks which have yet to establish themselves in public esteem. The practice is however very hard to eradicate as a low dividend is apt to be understood as an admission of doubtful prospects for a bank. Since the public does not and cannot discriminate between prudent policy and admission of frustrated hopes, a bank management which has the courage to declare a low dividend may find itself inviting the very disaster it is seeking to avert.†

* Pp. 187; 195 ; 201; 207; 225.

† Table XXXIV

TABLE XXXIII

	Rate of earning = Total Earnings. / Total Liabilities.				Gross Profit Rate = Gross profits / Total Liabilities.							Expense Total / Total			
	Central Bank of India	Punjab National Bank.	Allahabad Bank.	Indian Bank.	Bank of Baroda.	Bank of India. 1906—.58 1907—2.68 1908—2.22 1909—2.14 1910—1.77	Punjab National Bank.	Central Bank of India.	Allahabad Bank.	Imperial Bank.	Indian Bank.	Bank of India. 1906—.19 1907—.68 1908—.66 1909—.56 1910—.52	Bank of Baroda.	Central Bank of India.	Imperial Bank.
1910	...	...	...	5.69	...	...	...	...	...	...	3.57	...	...	...	...
1911	...	...	...	6.70	...	1.50	...	...	...	...	4.03	0.52	...	...	...
1912	4.12	6.57	...	6.44	2.41	1.96	4.32	1.81	...	...	3.86	0.55	1.52	0.6	...
1913	13.9	7.59	5.6	8.68	...	2.40	...	5.26	1.70	...	5.42	0.68	...	3.5	...
1914	7.41	8.14	6.1	7.98	2.52	2.20	4.10	4.45	2.28	...	4.67	0.82	1.76	3.15	...
1915	5.47	5.89	5.3	6.05	2.56	2.41	3.00	2.58	2.20	...	3.61	0.72	1.08	1.86	...
1916	4.13	6.24	5.2	6.68	2.16	2.40	3.21	2.21	2.27	...	4.36	0.65	0.75	0.79	...
1917	3.58	6.99	...	6.43	2.21	1.98	3.56	1.84	...	...	3.86	0.64	0.88	0.59	...
1918	5.31	...	5.0	6.83	2.08	2.39	...	3.34	2.07	...	3.85	0.95	0.60	2.10	...
1919	4.17	...	5.2	5.83	1.45	1.66	...	2.68	1.82	...	3.36	0.52	0.56	2.00	...
1920	6.71	...	7.0	7.56	1.59	2.92	...	2.68	2.43	...	4.41	0.48	0.55	1.58	...
1921	5.86	...	...	6.54	1.99	2.28	...	2.10	...	3.19	3.48	0.60	0.74	1.02	1.39
1922	6.33	...	8.2	7.93	1.98	2.60	...	2.34	1.07	3.34	4.71	0.75	0.78	1.37	1.55
1923	6.01	...	6.6	7.56	1.89	2.29	...	2.43	2.14	3.21	4.61	0.61	0.81	1.27	1.54
1924	7.04	...	8.4	8.02	1.86	2.43	...	3.03	2.98	3.29	4.65	0.66	0.86	1.61	1.65
1925	6.10	6.87	6.5	7.87	1.65	1.95	2.43	2.61	2.50	3.36	3.21	0.66	0.82	1.49	1.84
1926	5.45	6.49	6.9	5.81	1.63	1.76	2.12	2.32	2.41	3.53	3.45	0.68	0.88	1.30	1.89
1927	5.77	6.75	7.3	5.73	1.71	2.09	2.11	2.34	2.32	3.31	2.84	0.72	0.90	1.45	1.96
1928	5.79	6.43	7.1	6.66	1.55	2.26	2.10	3.43	2.31	3.57	3.41	0.78	1.02	1.52	1.87
1929	5.99	7.81	6.8	6.51	1.43	2.25	2.39	2.53	2.09	3.59	3.75	0.81	0.80	1.65	1.92
1930	5.12	6.68	7.1	6.32	1.37	1.85	2.62	2.36	2.19	3.36	3.05	0.77	0.82	1.34	1.84
1931	5.82	7.83	7.7	6.6	1.28	2.16	3.06	2.78	2.24	3.33	3.08	0.88	0.78	1.78	1.97
1932	4.58	6.06	8.1	5.44	1.21	1.47	3.21	2.19	2.32	3.41	2.58	0.75	0.69	1.55	1.81
1933	4.11	6.30	7.1	5.60	1.54	1.65	2.34	1.67	2.11	2.32	3.04	0.85	0.87	1.07	1.69
1934	3.83	6.68	6.3	5.68	1.40	1.92	3.75	1.92	2.44	2.76	3.42	0.86	0.84	1.04	1.61
1935	3.64	5.38	6.0	4.08	1.56	2.05	2.93	1.75	2.44	3.13	2.17	0.86	0.88	1.07	1.74
1936	3.24	4.82	5.5	3.75	1.40	1.90	2.63	1.75	2.47	2.63	1.91	0.82	0.79	1.09	1.50
1937	3.57	4.85	...	3.77	1.81	1.96	2.79	2.27	...	2.52	2.02	0.83	1.00	1.45	1.42
1938	3.87	4.94	...	4.24	1.74	2.01	2.91	2.15	...	2.64	2.35	0.88	1.06	1.33	1.43
1939	...	...	...	...	...	...	...	...	...	...	2.71	...	...	...	...
1940	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...

Ratio = Expenses. / Liabilities			Net profits Rate = gross profits rate—expense ratio.							Salaries as percentage of gross profits.					
Allahabad Bank.	Punjab National Bank.	Indian Bank.	Allahabad Bank	Punjab National Bank.	Bank of Baroda.	Central Bank of India	Bank of India 1906— .89 1907—1.95 1908—1.56 1909—1.58 1910—1.24	Imperial Bank of India.	Indian Bank.	Allahabad Bank.	Imperial Bank.	Central Bank of India.	Bank of Baroda.	Bank of India. 1906—15.7 1907—15.8 1908—13.4 1909—15.2 1910—17.2	Indian Bank.
...	...	1.06	...	...	...	...	...	...	2.51	...	...	...	...	...	17.7
...	...	1.38	...	...	...	...	0.98	...	2.70	...	...	...	...	20.5	18.9
...	2.52	1.34	...	1.80	0.89	0.71	1.41	...	2.52	...	...	24.5	15.6	1808	21.0
.92	...	1.45	0.78	...	...	1.76	2.28	...	3.97	41.9	...	14.9	...	17.1	16.8
1.85	2.87	1.28	0.88	1.73	0.76	1.30	1.38	...	3.19	41.2	...	30.2	19.2	22.4	23.4
1.30	1.50	1.53	0.90	1.50	1.48	1.17	1.69	...	2.08	40.9	...	25.7	19.4	17.9	26.1
1.31	1.72	1.39	0.96	1.49	1.41	1.42	1.75	...	2.97	39.0	...	19.9	19.2	18.1	19.2
...	1.90	1.30	...	1.66	1.38	0.75	1.34	...	2.56	...	...	19.7	17.0	14.0	19.0
1.30	...	1.58	0.77	...	1.48	1.24	1.44	...	2.32	39.0	...	14.6	16.8	18.2	23.1
1.21	...	1.38	0.61	...	0.89	0.68	1.14	...	1.98	42.5	...	16.1	20.4	14.6	24.1
1.43	...	1.66	1.00	...	1.04	1.10	2.44	...	2.75	39.1	...	22.8	19.4	9.7	23.2
...	...	1.78	...	...	0.25	1.18	1.68	2.0	1.70	...	28.7	53.9	21.8	15.6	30.0
.86	...	2.18	0.21	...	1.20	0.97	1.85	1.79	2.58	52.1	30.9	31.3	25.8	18.0	27.7
1.72	...	2.24	0.42	...	1.08	1.16	1.68	1.71	2.37	58.5	31.4	29.3	26.1	17.3	29.9
2.14	...	2.06	0.84	...	1.00	1.42	1.77	1.64	2.57	48.8	33.1	30.9	28.7	17.6	26.9
2.00	1.22	1.75	0.50	1.21	0.83	1.12	1.29	1.52	1.46	52.2	37.1	35.5	30.7	21.1	32.1
1.89	1.22	1.90	0.52	0.90	0.80	1.02	1.08	1.64	.94	52.8	38.6	35.1	30.8	24.9	37.5
1.79	1.40	1.55	0.58	0.71	0.81	0.89	1.87	1.85	1.29	58.3	38.2	39.7	32.2	20.6	31.9
1.80	1.47	1.40	0.51	0.68	0.53	0.91	1.48	1.70	2.07	55.7	38.3	43.9	35.8	19.4	24.4
1.61	1.95	1.46	0.48	0.94	0.68	0.88	1.44	1.67	1.89	56.8	39.1	44.6	38.2	21.3	22.3
1.69	2.14	2.28	0.50	0.48	0.55	1.02	1.08	1.52	.77	56.0	40.6	41.3	38.9	25.4	25.3
1.77	2.78	1.82	0.47	0.28	0.55	1.00	1.33	1.36	1.26	57.1	44.5	35.1	37.3	23.3	29.7
1.81	2.04	1.72	0.51	0.17	0.52	0.64	0.72	1.60	0.86	57.3	38.9	35.5	35.6	31.2	29.2
1.62	2.53	1.82	0.49	0.31	0.67	0.60	0.82	1.18	1.22	55.9	44.4	45.3	39.2	30.2	23.4
1.90	3.40	1.69	0.54	0.35	0.56	0.88	1.06	1.15	1.73	51.2	43.5	37.2	31.1	26.3	22.1
1.93	2.62	1.28	0.51	0.31	0.68	0.68	1.19	1.39	0.89	51.7	41.5	41.6	31.7	26.8	32.6
1.94	2.84	1.22	0.58	0.20	0.61	0.66	1.06	1.18	0.69	55.0	41.7	36.5	32.0	26.2	37.5
...	2.44	1.35	...	0.25	0.51	0.82	1.18	1.10	0.67	...	41.7	31.3	29.8	26.4	39.9
...	2.22	1.57	...	0.69	0.66	0.62	1.18	1.16	0.73	...	41.2	34.3	32.5	27.1	57.1
...	...	1.94	...	...	...	...	...	...	0.76	...	...	...	...	...	34.6
...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...

TABLE XXXIII—*Contd.*

	Net Profits as Percentage of Capital and Reserve.						Net Profits as Percentage of gross Profits.											Percentage of Net Profits distributed as dividend.			
	Indian Bank	Imperial Bank.	Allahabad Bank.	Central Bank of India.	Punjab National Bank.	Bank of Baroda.	Imperial Bank	Allahabad Bank.	Punjab National Bank	Bank of India.	Central Bank.	Bank of Baroda.	Indian Bank.	England and Wales.	United States (Member Bank)	France.	Switzerland.	Allahabad Bank	Bank of Baroda.	Bank of India.	Bank of Mysore.
1910	8.0	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1911	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1912	8.9	...	...	...	18.56	17.45	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1913	12.6	...	9.37	6.06	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1914	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1915	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1916	10.9	...	8.01	...	7.59	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1917	...	...	...	11.07	8.14	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1918	...	...	...	...	...	10.92	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1919	...	...	10.1	10.92	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1920	14.1	...	14.20	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1921	...	13.12	...	...	...	13.82	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1922	...	...	8.85	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1923	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1924	12.8	...	10.98	8.79	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1925	8.7	13.61	...	...	17.01	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1926	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1927	...	10.02	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1928	18.55	...	...	...	10.75	7.94	...	...	...	...	...	...	...	...	...	...	...	64.5	...	52.4	59.3
1929	18.0	...	...	5.16	...	...	46.8	23.0	32.4	63.6	34.8	44.0	60.9	83.0	35.8	...	45.4	...	76.1	...	...
1930	13.6	...	7.50	...	...	...	46.7	22.5	18.1	58.2	43.0	40.3	48.5	96.3	1.0	...	24.7	...	83.1	...	...
1931	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	66.9	...	...	56.6
1932	11.80	...	7.17	...	...	...	...	...	...	...	...	...	...	93.7	Loss	...	11.7	...	...	89.0	...
1933	12.81	12.74	...	6.16	...	...	39.4	23.3	10.5	49.6	35.4	43.3	44.4	93.8	Loss	...	Loss	...	...	...	...
1934	...	...	...	...	...	...	...	...	...	...	...	...	...	89.8	Loss	...	21.4	...	...	...	...
1935	...	...	...	...	...	...	...	...	...	...	...	...	...	87.2	21.8	...	16.9	60.9	...	...	...
1936	...	...	...	...	...	...	43.8	21.5	10.8	59.6	37.6	43.2	...	84.8	42.9	...	25.5	...	65.1	...	...
1937	...	...	...	...	5.00	10.76	43.6	...	12.4	57.4	35.7	44.4	33.1	83.8	29.5	...	34.2	41.6	...	50.8	63.7
1938	10.98	9.54	...	11.12	9.86	9.01	...	...	23.8	56.0	38.2	37.7	33.7	...	...	...	...	...	...	...	...
1939	11.8	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...

TABLE XXXIV.

	Bank of India		Bank of Baroda		Bank of Mysore		Allahabad Bank		Punjab National Bank	
	Rate of Dividend.	Highest and Lowest price of Share.	Rate of Dividend.	Highest and Lowest price of Shares.	Rate of Dividend.	Highest and Lowest price of Shares.	Rate of Dividend.	Highest and Lowest price of Shares.	Rate of Dividend.	Highest and Lowest price of Shares.
1918	10	103-87	12	93-82½	14	215-185	18	325-281	4	75
1919	10	105-97½	10	82-76	14	220-212½	18	306-291	5	55-51
1920	10	95-79½	10	77-69	14	220-200	18	315-285	5	80-55
1921	10	90-72½	10	72-58½	12	220½-162½	18	285-249	6	82-80
1922	11	96½-74	10	75½-60	13	198-160	18	250-228	6	125-82
1923	10	108½-96½	10	101½-75½	13	222-193	18	327-220	6	125-99½
1924	10	121½-104½	10	121½-104½	14	270-214	18	375-316	6	104-96½
1925	10	126½-115½	10	105½-96	14	277½-270	18	400-375	6	104
1926	11	142-125½	10	119½-96	14	307½-272	18	398-352	6	104-100
1927	11	147-136½	...	...	14	301-283	18	388-372	6	103
1928										
1929										

CHAPTER VIII.

THE RESERVE BANK OF INDIA

In his annexe to the Chamberlain Commission's Report, Keynes developed the first serious and comprehensive scheme for a central bank for India. The need of a central bank did not however become an article of accepted faith in India till central banks were proclaimed in international conferences as the only protection against economic and monetary chaos of the post-War kind. The Hilton-Young Commission thereafter discovered or pretended to discover "the inherent weakness of a system in which the control of currency and of credit is in the hands of two distinct authorities whose policies may be widely divergent, and in which the currency and banking reserves are controlled and managed separately one from the other." It rejected the proposal to transform the Imperial Bank of India into a central bank for the purpose in a doctrinaire manner and elaborated a scheme for a new central bank, the main features of which were later incorporated into the Reserve Bank of India.

It is necessary to recall the background to the present Reserve Bank of India Act of 1934. For, the main constituents of that background still persist and may influence the future working of the Reserve Bank in a material manner.

Action on the conclusions of the Hilton-Young Commission was taken in January 1927 with the introduction in the Legislative Assembly of a bill for the Reserve Bank. In this bill, the Bank was envisaged as a shareholders' bank with a majority of the Board of Directors elected by shareholders and a Governor and Deputy Governor nominated by the Governor-General-in-Council. A Joint Select Committee of the Assembly to which the bill was referred made important changes. In the first place, it held that the capital of the bank should be supplied by the State since it is an

invariable experience that the participation of shareholders in the control of joint-stock enterprize is a mere myth and power always falls into the hands of a self-elective, close oligarchy. Secondly, while active engagement in agriculture, commerce, finance or industry was a desirable qualification in a member of the Board, membership of the Indian or local Legislatures or of the Board of Directors of Cooperative Banks should not be a bar, as proposed in the Bill. Rejecting the shareholders principle in this manner, the Committee then proceeded to indicate how the Governing Board of the Reserve Bank was to be created. Six members of the Board out of a total 15 were to be elected by the Indian and Local Legislatures and the majority was to be Indian. The Committee insisted that either the Governor or the Deputy Governor must be an Indian. These changes were suggested on the ground that the Executive in India in no way represented or was responsible to the Indian public and that its nominations meant in effect alien political influence in the place of Indian political influence.

At one stage, Government were willing to give up the shareholders principle so far as the supply of capital went but insisted that the bill would have "to live or die according to our success . . . in finding a satisfactory directorate." After a visit to London for discussion by the Finance Member, however, Government tried to revert to the shareholders' principle but the new bill was disallowed by the President of the Assembly. In February 1928, after some erratic voting in the Assembly, the Government abandoned the Bill.

The immediate cause which brought a Reserve Bank into existence was not the monetary and banking needs of the country but impending changes in the Central Government which involved the transfer of the Finance Portfolio and Finance Department to a minister responsible to a Federal Legislature. The Second Report of the Federal Structure Committee (13th January 1931) described it as "a fundamental condition of the success of the Constitution that no room should be left for doubts as to the ability of India to

maintain her financial stability and credit, both at home and abroad." In the sphere of currency, credit and exchange, this meant according to the Parliamentary Joint Committee on Indian Constitutional Reform (1933-34) that "a Reserve Bank on a sure foundation and free from political influence should already have been established and in successful operation before the Constitutional changes at the Centre take place."* The Joint Committee was as a matter of fact already anticipated by the Reserve Bank of India Act 1934 which was piloted through a legislature which could have claimed for itself anything except representative character.

The "sure foundation" of the Reserve Bank was made clear in Section 153 of the subsequent Government of India Act 1935. No Bill or amendment which affects the coinage or currency of the Federation may be introduced or moved in either chamber of the Federal Legislature without the previous sanction of the Governor-General in his discretion. The restrictions relating directly to the Reserve Bank as such are even more significant. The White Paper proposals which were the basis of the work of the Joint Committee had suggested such prior consent only in regard to the powers and duties of the Bank as may be included in a Reserve Bank act. But the Act of 1935 taking its cue from the Report of the Joint Committee† requires such prior consent not only to changes in the "functions" but also the "constitution" of the Reserve Bank of India. In the light of the previous history of the question given above, the object behind this extension of restrictions is quite obvious.

We have already discussed some of the problems involved in the creation of a Reserve Bank in our examination of the status and working of the Imperial Bank of India before 1935. On several grounds, the Imperial Bank had a good claim to be considered as the most natural heir to the privileges and responsibilities of a central bank. The more important among them were, its size and resources, gradual but natural tendency to harmonisation of commercial and central banking functions, the high liquidity of its assets

* Report, para 300.

† Report, para 301.

secured and enforced by law, a growing friendliness and acceptance of its leadership on the part of other banks, the clear and traditional emphasis on public interests in the appointment of its executive, an unmistakable trend towards Indianisation in the ownership of its capital and management etc.* These facts have to be borne in mind in assessing the worth and value of the new institution created by the Act of 1934.

Constitution

The Reserve Bank of India is a shareholders' bank. Its share capital of 5 crores is divided into fully paid-up shares of Rs. 100 each. Any person domiciled in India and any company registered under the Indian Companies Act can become a shareholder. In the case of persons who are ordinarily resident in India but domiciled in some other part of the Empire and companies which have branches in India but are incorporated under the law of some other part of the Empire, it is a condition of shareholding that the government of the parties concerned should not be discriminating against Indians in any way.

Precautions were taken to prevent accumulation of power in particular parts of India or in a few hands. Initially, the aggregate shares were alloted on the basis of relative importance to five areas, Bombay, Calcutta, Delhi, Madras and Rangoon—into which the country was divided for the purpose. Secondly, while one vote was allowed to be cast for each five shares at elections to the local Board of the area concerned, the maximum number of votes for each shareholder was fixed at 10. As was to be expected, however, economic power and inherent tendencies of joint stock enterprize are slowly frustrating both these objects. As the law does not prohibit the transfer of shares from the register of one area to the others, the financial power of Bombay is gradually asserting itself. Its shareholding which amounted to 140 lakhs on 1st April 1935 rose to 205 lakhs by 31st December 1938, every other area sustaining a loss. Again, since the ordinary shareholder understands

* Pp. 81-98.

little and cares less for the public importance of the Reserve Bank but is only interested in the scrip as an investment, shares of the Bank are gradually accumulating into fewer and fewer hands. Between the dates mentioned just now, the number of shareholders has fallen from 92 thousand to about 60 thousand, a decline in which all the five areas share more or less. Short of a limitation on the number of shares which an individual may be permitted to hold and prohibition of transfer from one area to another, it is difficult to counteract this drift. Leaving out of account danger of evasion and arbitrary interference with the values of shares, it is still very doubtful whether unwilling shareholders will take any interest in elections or prove desirable or enlightened voters. It should not be surprising if as in France and England, shareholding is in the course of time concentrated in a few plutocratic families.

As the history of several central banks proves, the existence of shareholders is as a rule an immaterial factor in their actual working. Either by tradition as in England or by law as in France, the United States and elsewhere, the day to day executive power and consequently the predominant share in the framing of policy are vested in persons who acknowledge no responsibility to any one save the country at large or immediately, the government of the country. This precedent is followed by the Reserve Bank Act of India in that the appointment and removal from office of its Governor or Deputy Governors, approval of their salaries and allowances, fixing of their terms of office, any officiating appointments connected therewith, supersession of the Central Board, liquidation of the Bank itself are vested in the Governor-General who is to act in his discretion. But this adoption of the practice of other countries is merely one of form only and not substance. The relationship of the Governor-General to the people of this country has no parallel elsewhere and this deprives the arrangement of its usual import and significance.

The general superintendance and direction of the affairs and business of the Bank are entrusted to a central Board

of Directors. This Board consists of the aforesaid Governor and Deputy-Governors, four Directors nominated and removable by the Governor-General in his individual judgment, eight Directors elected by local Boards of the five areas and one government official nominated by the Central Government. A Local Board is constituted for each of the five areas, composed of five members elected from among themselves by the shareholders and not more than three members nominated by the Central Board and representing territorial and economic interest not already represented in the Board. Special attention is to be given to the interests of agriculture and co-operative banks in these nominations. Local Boards are to advise the Central Board on such matters as may be generally or specially referred to them and perform duties which are delegated to them.

Freedom from political influence desired by the Joint Committee is secured by two main disqualifications which apply to Directorships and Membership of Local Boards. No salaried government official or salaried official of a State in India can hold these positions. Members of the federal or provincial legislatures who desire to hold these positions must sever their connection with those bodies. Among other persons similarly disqualified are officers or employees of banks other than co-operative banks or persons who do not hold unencumbered shares of the Bank to the nominal value of at least Rs. 5,000.

Monopoly of Note-Issue and Management

The monopoly of note issue is intended to give to the Reserve Bank complete control over the volume of cash and therefore credit in the country. As a means to the control of the entire monetary and credit situation, its usefulness may be analysed from different angles.

In some countries notes or notes and coins which comprise their legal tender constitute the bulk of purchasing power. They are the main media of transactions. In others, they hold an inferior status as means of exchange

which figure largely in the smaller transactions which arise from or co-exist with the volume of big transactions. The former situation is well typified by France in which the note circulation of the Bank of France exceeds by a third the aggregate time and demand deposits of the Bank of France, Parisian Banks and provincial banks. Control of the legal tender means in such countries control of the entire monetary system. In countries like England and the United States where 90 per cent. and even more of the transactions are discharged by means of cheques, the demand for currency is largely a demand for deposits. The requirements of legal tender are apt to be very sporadic and to lag a good deal behind the creation of bank money. The power to control the volume of legal tender is therefore an ultimate power which is ill-suited for expeditious effects and still less for anticipatory checks. Such countries have had to develop close-knit banking systems and well-articulated structure of interest rates in which an impulse released from the Central Bank travels automatically to the furtherest extremeties of the monetary organization. The object sought to be achieved is to effect the volume of credit directly and not mediately through the volume of legal tender.

The monetary organization of India belongs to the first type. Though the public has been long familiar with three chief forms of purchasing power, namely, rupees, currency notes and chequeable deposits, their relative importance today is very different from what it was a few decades ago. Institutional conditions no doubt set ultimate limits to the use of each form. But within these limits, considerations of convenience, average size of transactions, per head income, level of prices, etc., influence the use of each and there are good grounds to surmise that these factors have changed considerably in the last forty years. On the whole, the extension of notes and cheques has been favoured at the expense of rupees.

As early as 1913, the receipts of banks in Bengal and Bombay showed for rupees as low a percentage as 8

to 24 as against a percentage for currency notes of 70 to 88. In a poor and predominantly agricultural province like Madras, the percentage of rupees in the receipts reached 44 only as against 52 for currency notes.*

The situation must have altered much more in favour of notes when the Hilton-Young Commission deliberated on the currency and banking problems of India. It was stated before the Commission that places which at the beginning of the century sent their remittances to banks in nothing but rupees were sending twenty-five years later as much as half in currency notes.†

Since the post-war boom year 1920, there began a remarkable return of rupees from circulation which was much intensified later by the deflationary movement of the thirties. Between 1920-21 and 1937-38, 138 crores of rupees have flowed back into the Currency Office. The note-circulation has actually recorded an increase in the same period.

It is, therefore, more than probable that today in volume, currency notes out-distance rupees by a large margin. Official witnesses in India placed before the Hilton-Young Commission estimates tending to show that including Rs. 85 crores of silver coin and bullion then held in the Paper Currency Reserve, the total amount of rupee coin in issue at the time was Rs. 350 to Rs. 400 crores. Of this huge volume, 150 crores only were regarded as serving monetary purposes. Taking into account the great return of coins from circulation, it appears highly improbable that the volume of rupees in circulation could be today anywhere in the neighbourhood of active note circulation which amounted to Rs. 183 crores in 1937-38.‡

As between currency notes and chequeable deposits the former still exceed the latter which however are slowly

* Receipts of Banks

	Percentage in Currency Notes	Percentage in Rupees.	Gold
Bank of Bengal (4 weeks ending 28 June 1918)	69.83	24.27	5.90
Bank of Bombay (February to May 1918)	81.39	15.56	3.05
Bank of Madras	51.91	44.12	3.92
National Bank (10 May to 30 June 1918)...	88.21	7.95	3.80

Volume III. Appendices, Chamberlain Commission. Pp. 724-726.

† Minutes of Evidence, Hilton-Young Commission. Q. 7939-40.

‡ Para 123.

gaining over them. If allowance were made for the undoubted greater velocity of deposits, it would be difficult to say which predominate.* This might be compared with the proportion of deposits to note circulation which is 3 : 2 in France and 12 : 1 in the United States.

It is clear in any case that notes and chequeable deposits make up the bulk of the purchasing power of the country. Control of the monetary system means therefore mainly the control of notes and deposits. Even if rupees held a status higher than a mere means for small change, the demand for them would record economic changes long after they have gathered momentum. Besides, there is ample evidence to believe that the quantitative relationship between the three forms of purchasing power is not of an invariable kind.

The presumed close relationship or dependence between credit and legal tender etc., overlooks the natural resistance which any sudden and drastic changes in purchasing power inevitably set up. The close dependence may assert itself in the long run but measures of credit control must act quickly and with certainty. Indian experience itself furnishes illustrations of the high elasticity and mutual independence which different forms of exchange media disclose in practice.

In 1920, a hectic sale of reverse councils in the course of a few months withdrew from circulation rupees and notes to the extent of 39·07 crores. Nothing, however, was detracted from the volume of deposits. On the contrary, during the same months, there was a rise in deposits of 23½ crores in which the Presidency Banks and Indian joint stocks banks shared equally. The rate of the Bank

* (in crores.)

		Demand Deposits. (Scheduled Banks).	Active Note Circular action.	Bank Clearings.
1935-36	...	128	168	1848
1936-37	...	128	175	1931
1937-38	...	185	188	2051

Deposits of scheduled banks accounted for about 90 per cent. of deposits of all banks.

Cf.......Percentage of Notes in payments (cheques and notes) of maturing commercial bills at Bank of France.

1925	...	54
1926	...	42
1927	...	43
Average	...	46

of Bengal was higher by 1/2 per cent. only than in previous 2 years and the rate of the Bank of Bombay reached a slightly higher level. The burden of the stringency was mainly thrown on the open bazar where the rate was 11 per cent. as against the Presidency Banks' rate of 5 per cent. A study of the cash-ratios of Indian banks indicates that they are adaptable to changes in monetary conditions within quite wide limits.*

Again, in the 18 years ending with 1937-38, 118 crores of rupees have returned from circulation. But there has been actually a net absorption of currency notes to the amount of 49 crores. Only in one year, 1924-25, there was a return of notes from circulation against an absorption of rupees. The volume of deposits, as is to be expected, continued stable till 1930 and with the expansion of bank branches, etc., grew fast thereafter.

Control of the monetary system in India means then very largely control of note-issue and control of deposit-currency. It was a weakness in the position of the Imperial Bank that while its very size and expanse gave it some control over credit, the control of legal tender was retained by the government in its own hands. The step in the line of natural evolution should have been to hand over the management of the note-issue to the Imperial Bank. But a new institution has been created to undertake both the responsibilities. Our subsequent discussion will make clear whether the new institution really unifies control of currency and credit or the old dichotomy of monetary management continues under a different form.

(1) Under our present reserve arrangements, which are described in detail presently, domestic lack of confidence in the note-issue or an internal drain by presentation of notes for encashment is not contemplated as a factor which should influence the size of our reserves. Our present arrangements are aimed at securing a certain volume of gold or gold equivalents in the reserve. Gold does not circulate in the country and indeed the condition

* Pp. 185-87.

of redeemability, namely, sales and purchases of gold in bars of 400 oz. each, is intended to discourage raids on the reserve for domestic purposes. A small quantity of rupees is no doubt stipulated for as a part of the reserve but it is insignificant as compared with the volume of gold and gold equivalents and is obviously meant to meet the requirements of people for small change. This arrangement is justified only on the presumption that the people of India has full confidence in the note-issue of the country and in crisis would be quite content with supplies of notes.

Our reserve then is held largely with a view to our probable external liabilities. There are two points to be noted in this connection. Any demand on our gold resources is now connected directly with our volume of foreign trade and only mediately with the internal volume of purchasing power in the country. As a matter of fact the old view that equilibrium of foreign debits and credits requires a continuous effort to maintain the domestic price and income structure in equilibrium with price and income structures abroad contained a large element of exaggeration and unreality. Under conditions of continuous international trade, it is unlikely that prices and incomes will fall out of step very far without calling into action automatic and immediate correctives. The more frequent causes of disequilibrium are temporary breakdowns of markets, divergences in interest-rates, etc., which cause a temporary excess of foreign debits over credits but which do not justify measures to restrict or diminish the volume of domestic credit. Interference with price and income structure is more often than not a necessity arising out of general world movement towards inflation or deflation. Secondly, in so far as movements of our trade-balance are influenced by the domestic price-level, it would have been more logical to fix the reserve proportion on the basis of notes and deposits rather than notes alone.

(2) Although notes form the largest single constituent of our purchasing power, it is not to be presumed that the state of money and credit will be immediately reflected

in the volume of notes held in the Banking Department of the Reserve Bank. According to present law, commercial banks need hold only a small fraction of their reserves as compulsory deposits with the Reserve Bank. While in recent years their cash on hand and at the Bank has been about 15 per cent. of their deposits, the minimum amount to be lodged by them at the Reserve Bank is 2 per cent. of their time and 5 per cent. of their demand deposits or on the average 3½ per cent. only of their total deposits. In regard to the excess over this minimum, banks have two alternative courses open to them. They may hold the whole of this excess with themselves in their vaults in which case it will consist perforce of notes and coin. Alternatively, after keeping on hand a bare minimum of till money, the rest could be deposited with the Reserve Bank.

According to the present practice, banks hold quite a large proportion of these excess reserves with themselves in their vaults in notes or coin. Coins are probably a small part while the greater part consists of currency-notes, perhaps currency notes of larger denomination. Even if we assumed that the Big Five held only 4 per cent. of their aggregate deposits in 1938-39 in this manner, it would mean a reserve in notes in their vaults of about 3 crores. For all scheduled banks whose deposits were then about 240 crores, the cash actually held as excess reserve would be 6 crores out of a total banking reserve of 22 crores. This figure may be compared with notes in circulation which amounted to about 185 crores and notes held in the Banking Department of the Reserve Bank which amounted to about 28 crores. The note circulation appearing in the returns of the Central Bank included of course, the 6 crores which were really dormant in the vaults of banks.

It is clear that if inflation took the form of more notes in public hands, the banks could support it for some time without recourse to the Reserve Bank. Intimation to the Reserve Bank may be delayed till banks begin to feel that

their stock of notes is falling to imprudently low levels. If inflation were to take place in the form of deposits, the volume of mutual claims at the clearing house should immediately reveal the drift of things. In case a more definite signal in the shape of a demand for more notes is awaited, the commercial banks will receive it first after some lapse of time and the Reserve Bank will become aware of the situation only when commercial banks decide to replenish their coin and notes. If banks made it a practice of holding all excess over till money as deposits at the Reserve Bank, intimation of credit conditions will reach the Bank at a much earlier stage.

There is another reason why the practice of holding all excess over till money as a deposit with the Reserve Bank is likely to promote efficiency of credit control. The liabilities of the Reserve Bank in the form of notes are regulated by law by prescribing certain reserve requirements. But the deposits it holds on account of scheduled banks are subject to no such restrictions. To the extent to which these deposits are not withdrawn in the form of notes to meet the requirements of circulation, the Reserve Bank can inflate them to any extent by rediscounts or grant of loans. Since a deposit with the Reserve Bank is treated by banks as equivalent to cash and is usable at clearing for meeting adverse balances, it may become the basis for a multiple expansion of credit. In this way, the fact that all the surplus cash of the community is concentrated in the Reserve Bank and that, of any balances created in favour of scheduled banks, only a fraction need be withdrawn for expansion of the circulation while the rest may be retained at the Bank to satisfy compulsory reserve requirements puts enormous power into the hands of the Bank over the monetary system. If excess reserves were always retained in the vaults of banks, loans made by the Reserve Bank must immediately cause a drain on notes and limit its power to expand purchasing power.

(3) The Reserve Bank Act copied from the Bank of England its peculiar feature of the separation of Issue and

Banking Departments. During the long century which has elapsed since the Bank Charter Act of 1844, no other country outside the British Empire has found it necessary or advisable to adopt this practice. It is reasonable to ask in these circumstances what purpose such a separation is intended to serve or what special advantages it may offer to this country.

Historically, this separation marked the prevalence in England of the views of the Currency School over its rival, the Banking School. The Currency School argued that only bank-notes, which according to their proposals were to be freely convertible into gold and were to rise or fall with inflow or outflow of gold, were money. Other forms of means of exchange, particularly deposits were not money. The management of money including notes was no banking function at all and might be even entrusted to a government department. While no competition was admissible in the issue and management of money and while the aggregate of coins and notes was to behave as if it were fully metallic, the Currency School regarded the banking work of the Bank of England to be on the same footing as the business of other banks. The separation of the two departments was devised to mark this alleged distinction of principle between note-issue management and banking business.

Even in those early years, events speedily proved that the alleged distinction between notes and deposits did not exist and that the view of the rival school, the Banking School, that forms of currency were easily interchangeable and bore no fixed relationship to each other was the correct one. In the crisis of 1847, the note circulation of the country did not fall with the efflux of gold but deposits only fell. The subsequent enormous growth of deposits did away with the last vestiges of the particular belief of the Currency School. Besides, in those countries which accepted the principle of very strict restriction or almost complete abrogation of the commercial functions of their central banks, the other part of the doctrine of the Currency School, ill-conceived as it was, also ceased to have any validity.

As the Macmillan Committee on Finance and Industry point out, "the only solid reason" for this arrangement is that "the separation of the Issue Department has provided a convenient formula for dividing the profits of the Bank of England between the Treasury and the Bank itself." According to the British practice, the profits of the note-issue belong to the Treasury and the rest of the profits belongs to the Bank of England. The profits of the note-issue consist largely of the income from assets held against the fiduciary part of the note-circulation. The seggregation of the Issue Department and its assets facilitates calculation of these profits and the incidental expenditure. But as the Committee showed, this elaboration of organisation for this particular purpose is neither necessary nor conducive to accurate or just results.*

In any case, this argument has no relevance to the Reserve Bank of India whose profits are allocated on an altogether different basis. Under our arrangements, a cumulative dividend on the share capital of the Bank at a rate not exceeding 5 per cent. and as fixed by the Governor-General-in-Council is first assured to the shareholders. Out of the surplus, when certain prior claims of the Reserve Fund were met till it was raised to equal the capital of the Bank, shares were to be allocated out of the balance to additional dividend and the Governor-General in Council according to a certain scale. It is clear that we have no separation here of profits according to their source and therefore no justification on this ground for copying the unique bisection of the Bank of England.

The publication of separate balance-sheets for the Issue and Banking Departments conveys certain other implications which deserve to be examined closely. In the first place, the reserves of the central bank are linked indissolubly in the public mind with the note-circulation of the country. In the second place, the notes held in the Banking Department, which should represent the surplus which can be legally issued with the existing reserves

* Committee on Finance and Industry. (1931) pp. 143; 144.

naturally invite comparison with deposit liabilities of the Bank to the schedule banks.

The second consequence is well illustrated by reference to the beliefs and practices of the British system. Since the Act of 1844, England has adhered to the principle of a fixed fiduciary issue. The excess over the fixed fiduciary issue is required by law to be covered by gold coin or bullion to the full extent. This excess over the fiduciary issue is partly in actual circulation and partly, to the extent that trade and economic conditions do not require it, in the Banking Department. The notes in the Banking Department could be put into circulation at any time without infringing the law of note-issue regulation. The deposit liabilities of the Bank of England to joint-stock banks are the measure of the extent to which the Bank may have to meet a demand for notes. The relation between the two volumes, the notes in the Banking Department and bankers' deposits is the famous "ratio" or "proportion" of the British system.

It is clear that the "proportion" in so far as it has a guidance value has a simple and obvious meaning to the average business man in England. The simplicity and obviousness are due to the fact that above a certain minimum, every pound note must be covered with one £ of gold or in other words, notes in the Banking Department and the deposit liabilities of the Bank of England can be compared directly with each other on the basis 1 : 1.

In India, the arrangements are altogether different. Our law prescribes that gold and gold equivalents should not be less than 2/5ths or 40 per cent. of the assets held, *i.e.*, of the note-circulation. In other words, 8·47512 grains of fine gold in the reserve which has been defined as the gold equivlance of the rupee may justify the Reserve Bank in putting into circulation Rs. 2½ in notes. In the opposite circumstances, 8·47512 gold issued could be made use of to cause a deflation to the extent of Rs. 2½ in notes. It is clear from this that calculations of the excess notes which are available for issue with existing reserves cannot be simple or

obvious under our system. Even the British arrangement, much simpler as it is, has been described by the MacMillan Committee as "confusing and misleading to anyone who is not an expert." They adduced a further weighty condemnation on the ground that the words "reserve" or "proportion" under such an arrangement have quite different meanings from what they have elsewhere—as in India. The separation of Departments and balance-sheets of the Reserve Bank has taken place on such a basis that the inherent difficulties of its interpretation have been heaped on the difficulties of complicated reserve arrangements.*

The practice of the Reserve Bank itself is an admission of the inapplicability in the case of our note-issue arrangements of the principle of separation of departments. From 1935-36 to 1937-38, it maintained a volume of notes in the Banking Department which was approximately equal to its deposit-liabilities to scheduled banks. If closely adhered to, the practice may acquire a simple and logical meaning in ordinary circumstances, fluctuations in the two quantities indicating the trend of things. But the initial equating of notes in the Banking Department to the deposits of scheduled banks is obviously an arbitrary procedure which has no warrant in our note-issue regulations. The working of this arbitrary practice is well illustrated by events which happened in 1938-39. It appears that scheduled banks acquired balances abroad from the Reserve Bank whose corresponding item recorded a fall of about 9 to 10 crores. The acquisition was effected by a withdrawal from their statutary deposits to the tune of about 7½ crores and an increase of their loans and discounts at the Reserve Bank of about 2 crores and more. The Reserve Bank was thus confronted with a deflation of about 10 crores. The Bank preferred to add about 2·6 crores to the notes held in the Banking Department against an actual fall of 3·8

* Cf......"We have stated above that the proportional reserve system does not necessitate the separation of the banking and note-issue functions of a Reserve Bank......If nevertheless, in the plan submitted in our Report such a separation is proposed, it is because we have been impressed by the view put forward by many witnesses that the accounts of the Reserve Bank should be presented in the simplest possible form and that it is essential from this point of view to set out in a separate statement the assets and liabilities in respect of the note-issue. We think such a separation would inspire greater confidence in the note."
Report. Hilton-Young Commission. Para, 137

crores in Notes in Circulation and allow Rupee Coin in the Issue Department to mount up by about 7 crores. A net reduction of 8·2 crores in the volume of sterling and rupee securities in the Issue Department as against this inflow of Coin shows how a fraction of the incoming notes was cancelled and discrepancy allowed to arise between the fall in note-circulation and the addition to the notes held in Banking Department.

Central Banking Control—Its Technique and Relation to the Money-Market

A money market is by definition a market for borrowing and lending of short-term funds. As explained elsewhere,* these loans arise very largely in connection with trade in bills, stock-exchange operations and dealings between banks. Unlike ordinary loans and advances, a loan to the money market presumes no permanent relationship between banker and customer but is treated as a separate, self-contained transaction. While commercial banks are deeply interested in the market as offering highly liquid and safe outlets for investment, its working and character are of immense significance to credit and monetary control by the central bank. While open market operations might be sought as an instrument to influence both short and long term rates of interest, the bank rate gives the central bank direct contact with short rates and the money-market. The effectiveness of this contact and the speed with which it is able to affect the credit-structure are a measure largely of the organised and well-knit character of the market.†

The power of the central bank in relation to the money market depends firstly on how far the money market is accustomed to depend on its own funds and on funds borrowed from banks and secondly how far banks themselves have occasion to apply for rediscounts or loans from the central bank.

As we have already noted, the volume of bills arising in India is not very large and shows small prospect of any

* Pp. 118-30; 392-94

† Pp. 65-69. While deposit rates were related to the Bank rate in England as early as 1787, it was not till about 1911 that money market rates were similarly defined.

material growth. Our Shroffs, Multanis and Chetties who deal in these wares are willing to borrow until the rate of interest reaches a certain level and thereafter are able to fall back on private sources of funds which are by no means inconsiderable. The present process of levelling down of interest-rates may in the course of time dry up these sources but till that stage is reached banks could hardly be said to be in control of the bill-market.* The bazar bill rates which apply to bills discounted for small traders by shroffs are the highest rates in the Indian money-market. Sometimes they lose touch entirely with the rates of banks and till 1931, used to be markedly lower in Bombay than Calcutta. As for short and call loans for purposes other than investment in bills, they are made use of largely for dealings on the stock exchanges and the bullion markets. But they bear hardly any significant proportion to the deposits of banks.

As for the relationship between scheduled banks and the Reserve Bank of India, it is very difficult to appraise it in the present circumstances. The creation of the Reserve Bank has coincided with an ease of rates and plentitude of funds which have no parallel in our previous history. Many of the scheduled banks have reached a size and own funds on a scale which make them fairly independent of outside assistance in all but exceptional times. Besides, as is well-known, many small banks which are denied or find no access to the Reserve Bank have developed a practice of approaching the bigger joint-stock banks for any required aid. To the extent that such inter-bank lending prevails and Reserve Bank funds reach other banks through the medium of scheduled banks, the power of the Reserve Bank over the market is either frustrated or has to be shared with these banks. The real test will arrive when the present ease of funds gives place to stringency and the Reserve Bank tries to enforce its credit-lines.

* In 1896-97, the bazar quoted 8 per cent. for bills for which the Bank of Bengal was quoting 13½ per cent.

Q. 1735; 1968; 3431. Evidence, Fowler Committee.

During the deflation of 1920, the rate of the Presidency Banks reached only 6 per cent but the bazar rates shot up to 11 per cent.

Note by Sir C. Kisch. Appendices. Hilton-Young Commission.

The Bank-Rate

The Reserve Bank encourages or discourages scheduled banks to obtain more cash from itself by means of its bank-rate policy. The rate of the Reserve Bank is a minimum rate at which it undertakes to discount for the scheduled banks bills of certain defined qualities. The effectiveness of this rate depends on two things, its level, and the liberality or narrowness with which the bills to which the rate applies are defined.

The level of the bank-rate is not by itself a sufficient means of control. Even in those countries in which the rate is higher than the market rate of discount, its level is certainly not higher than the average rate earned by banks on all their assets taken together. The situation is even more difficult in India because interest-rates obtainable in different parts of the country show wide disparties. It has been shown in another place that while the earning rate of the Central Bank of India is somewhere near the pre-1935 " bank-rate," the earning rates of regional banks of the Punjab, U. P. and Madras are very much higher. A uniform minimum rate such as the Reserve Bank maintained in the last few years must surely prove in times of less abundant money either too high for certain areas or too low for certain others. Different regional rates for different parts will create other difficulties and indeed be frustrated on account of the presence in this country of banks with a wide network of branches. In these circumstances, it is difficult to foresee how the Reserve Bank will maintain effective touch with rates all over the country.

The same difficulties were encountered in the United States during the greater part of the existence of the Federal Reserve System. In the United States, regional variations even in open market rates are substantial while those in customers' rate are astonishingly wider. The Federal Reserve System tried at different times both uniform rate and regional rates and at present is working on the basis of a uniform rate. The further complication

of banks with branches in all parts does not however exist there.

A central bank like the Banque de France which combines commercial and central banking functions demonstrates its effectiveness in situations like these. The original object of founding the Banque de France was to make credit available to all parts at cheap rates. Government compelled adherence to this object by insisting on the creation of more and more branches at each renewal of the charter. The Banque works on the basis of a uniform minimum rate which applies to individuals as well as banks. Although the bigger banks quote a lower discount rate and denude the market of the best bills on offer, the smaller banks which quote higher rates are glad to discount at the Banque. Under the country-wide influence of the Banque de France, short rates have everywhere approximated to the discount-rate of the Banque which, while it "makes no claim to manage money and control credit after the manner of newer central banks nor . . . wish to dominate the money market" has yet never lost the financial leadership of the country built largely on its monopoly and management of the note-issue.

While the level of the bank-rate by itself is not the chief element in its effectiveness, it certainly proves decisive when combined with the restrictive (or liberal) manner in which the assets to which it applies are defined.

The Reserve Bank is allowed to buy and sell domestic or inland bills, sterling and bills on United Kingdom. In all ordinary circumstances, the dealings are confined to bank-endorsed bills. These "eligible" bills fall into three categories: ordinary, bona fide commercial bills with an outstanding maturity of not more than 90 days, bills of the same limited maturity but arising out of the holding of or trading in certain defined securities, largely government and finally bills which are to run for not more than 9 months and arise out of the financing of agricultural operations or marketing of agricultural produce.

The importance of this means of access to Reserve Bank cash has to be judged in the light of the quantity of such assets held by banks in India The bills portfolio of our scheduled banks has been on the average 3, 4, 6 and 5 crores for the four years 1935-36 to 1938-39. It is to be presumed that a portion at least of this quantity will not reach the standard and quality prescribed for or insisted on by the Reserve Bank. With these figures may be compared the aggregate reserves of the scheduled banks, cash on hand and balances at the Reserve Bank. These amounted in the aforesaid years to about 38, 32, 25 and 22 crores. Even allowing for the low volume of bills and high level of reserves caused by economic stagnation, it is clear that rediscount as a means of credit control has only a limited significance for India.

Alternative to rediscount, the scheduled banks can obtain loans and advances from the Reserve Bank. The Act permits the Reserve Bank to grant such accommodation to scheduled banks for fixed periods not exceeding 90 days against trust securities, gold and silver or documents of title to gold and silver, eligible bills of exchange and pro-notes, promissory notes of the banks themselves which are supported by documents of title to goods in possession of or assigned or pledged to the banks.

Commercial banks have one ground of preference for loans and advances as against discounts. A loan can be arranged for any period within the limits of law or repaid at any time according to the convenience or need of the borrowing banks. The discount of a bill transfers the property in the bills once and for all to the central bank. As against this preference for loans and advances, account has to be taken of the fact that most central banks charge a higher rate for them and as a matter of fact, discourage them as being of a non-self-liquidating character. Contrary to this common practice, however, our Reserve Bank makes no difference between its discount rate and the rate for loans and advances perhaps on the ground that in Indian conditions this must always be the main form of borrowing.

Even in England and France, discrimination against loans and advances appeared much later in their history—the initial practice being actually a discrimination in their favour !* The practice of the Reserve Bank presents another difficulty in that it is its avowed object to encourage the creation of bills and the growth of a bill-market. A lower rate for discounts is more in harmony with this avowed object.

As observed already, the last few years have been so remarkable for easy conditions and abundance of funds that the Reserve Bank has had hardly any important role to play. Bills purchased and discounted by it have hardly attained any significant volume except for the early months of the year 1939. "Other loans and Advances" have been hardly in existence, despite the fact that the investments of Indian banks are composed largely of eligible government securities and are at present running at very high levels. None of the big banks could be in need of funds and there is no means to ascertain how far the Reserve Bank has been willing to entertain the overtures of the smaller scheduled banks. A just appraisal of the policy and effectiveness of the Reserve Bank must however await the occurrence of stiffer monetary conditions.

Open Market Operations

The discouragement or encouragement offered by the bank-rate becomes effective only through the initiative of scheduled banks themselves. The Reserve Bank may itself initiate these effects by the purchase or sale in the open market of such assets as it is allowed to hold or to deal in. The bank-rate acts on the willingness of scheduled banks to borrow from the Reserve Bank; open market operations act on the willingness of banks to lend to their customers. Open market operations may be used either to supplement the effectiveness of the bank-rate or independently, within moderate limits, to narrow the gap between bank-rate and

* Bank of England discovered this form of lending against securities in 1836 and the rate was lower than its bank-rate i.e. discount rate.

Allowed to make loans against short-dated Government securities first, against all Government securities in 1834 and against railway and Paris Municipality bonds in 1848, the Banque de France raised its rate for loans higher than the discount-rate only in 1906.

market rates, to induce banks to move in step, to avoid the psychological difficulties of changes in the bank-rate, etc. On account of the character of the assets employed to carry out these operations, the Reserve Bank has in them a direct means to influence the long term rate also.

The extent and effectiveness of open market operations
depend on three conditions, the size of the resources which 1
the Reserve Bank can muster for the purpose, the quality
and volume of the assets it is permitted to deal in or hold, 2
the capacity and organisation of the market in which they 3
have to be carried out.

(1). The resources at the disposal of the Bank are derived from several sources. In the first instance, there is the capital and reserve of the Bank which today stand at 5 crores each. As the reserve has reached equality with capital, no further augmentation will now occur from that source. In the second instance, the Bank is the sole repository of the funds of government. These funds are of two kinds, those which accrue to the Bank in the course of the collection and disbursement of ordinary revenues and those which flow in and out because the Reserve Bank manages, on agreed conditions, public loans and debt operations of central and provincial governments. The time and manner of these operations no less than the incidental accumulation and dispersal of funds are important factors in the management of the money market. The aggregate funds held on behalf of government have been on the average as large as 11 to 12 crores.

The third source of its funds is the compulsory deposits of the scheduled banks. Every bank included in the schedule has to maintain at the Reserve Bank amounts equal to at least 5 and 2 per cent. respectively of their demand and time liabilities in India computed as averages of deposits held at the close of business on each Friday. In case of failure to maintain the required deposit, the defaulting bank has to pay penal interest on the deficit balance at a rate which may be five per cent. higher than the bank-rate at the maximum and for failure to make the incidental

returns of figures, it has to pay a penalty of Rs. 100 for each day of failure. Events have proved that it may be to the immediate advantage of an embarrassed bank to pay the penal interest and make use of its funds to meet its immediate needs. The existing law makes no attempt to prevent such a course of development and it is indeed difficult to see justification for any such prohibitions. If the Reserve Bank offers assistance in excess of the funds it holds from a particular bank, the question of a return of its compulsory deposit does not arise. If the Reserve Bank is not willing to discount or grant advances to that extent, it would be a grave injustice and against public interests not to permit the bank to save itself with its own unaided efforts and its own funds.

Another source of funds is dependent on the extent to which the machinery of the Bank is used by other banks for collection of bills or transfer of customers' funds. In all countries which lack the cheque habit or a sufficiency of bank branches, such facilities for collection and transfer serve to prevent large inflows into or expulsions from the banking system of cash and are for that reason a great boon to the money market. The Banque de France and the Reichsbank of Germany derive quite an appreciable part of their resources from this business. The Reserve Bank now and the Imperial Bank before it have been charged with the development of these facilities. As telegraphic transfers form the bulk of remittances and demand drafts or mail transfers are quite insignificant in volume, these operations do not mean at present any appreciable acquisition of funds.

It could be claimed in one sense, though in one sense only, that the resources of the Bank are virtually limitless. Under our present law of note-issue the Bank has a very large margin of gold or gold equivalents against which great quantities of notes could be issued. Theoretically at least, the posibilities of such inflation have hardly any measurable limits. In practice, of course, these powers are likely to be invoked only on exceptional occasions when

the assets of banks or individuals have to be converted into cash on a very large scale as in the case of a general panic and break down of the monetary and banking structure. The present practice of the Reserve Bank in regard to the volume of notes issued to and held in the Banking Department shows that in ordinary times and circumstances it does not intend to undertake open market operations beyond the means it is able to acquire in the ordinary way. Despite the existence of the proportional reserve system, the volume of notes in the Banking Department is almost exactly equal to the deposits of scheduled banks at the Bank.* Nevertheless, the potential aberrations of such a power should not be underrated. In all countries, the trading and business community is always highly critical of stiffening of interest-rates and restriction of credit and is generally able to exercise pressure in favour of stable or lower rates. In a country of farmers and cultivators like India, the desires of the mass must always tend to coincide with this particular prejudice of businessmen and its political power must be taken into account as a serious factor. If we add to this pressure of practical interests the new-born faith of academic economists in low money rates of interest and their power to achieve almost any miracle, it is clear that the bias of the whole system must always be towards creation of inflationary conditions and away from measures, howsoever necessary, for drastic revision of values, costs, expectations etc. Any doubts on this point have met with emphatic warnings in the recent monetary history of the United States.

What makes this one-sided power look rather suspicious is the invariable absence in the statutes of such central banks of corresponding powers to cause similar deflation. Withdrawals of currency and credit from circulation mean sale of assets which the Central Bank had already acquired and holds out of its ordinary resources. These resources, as we have already seen, are strictly limited in the case of our Reserve Bank. The counterpart to the power to cause

* P. 262.

limitless inflation, theoretically possible under our present law, would be a statutary power either to create and sell its own debentures and short term bonds or to raise the proportions of the compulsory reserves which member banks have to hold at the Reserve Bank. Such an arrangement has no place in our present Reserve Bank Act. In short, while the law recognises the possibilities of a need to enlarge the cash basis to any unusual extent, it does not anticipate the necessity or wisdom of similar drastic deflation. It is more than likely that this lack of symmetry in the powers of central banks has much to do with the general prejudice which has always prevailed on the Continent *e.g.*, France against the grant of open market operations powers to central banks. The objection is not merely the logical one that open market operations place costless credit at the disposal of banks while individuals have always to pay a price for it. The continental prejudice is rooted in the belief that the interference of open market operations does not permit the natural changes in the economic structure to express and work themselves out in changes of interest rates, etc., and that while inflationary panacceas find a place in the repertory of the central banks, the pains and penalties of deflation are scrupulously avoided. It is a poor weapon of currency and credit management when a central bank exists only to evade or moderate the impact of the inevitable penalties of imprudent expansion and unhealthy growth, if not indeed to cause and stimulate it.

(2) The assets which the Bank may acquire or own on its initiative may be described in a general way as follows.

The Bank is allowed to purchase or sell government securities of the United Kingdom maturing within ten years from the date of purchase without limitation of amount.

The bank is permitted to buy or sell securities issued by, or guaranteed as to principal and interest by, the Government of India or a Provincial Government of any maturity or such securities issued or guaranteed by a local authority

in British India or by Indian State as may be specified by the Governor-General-in-Council on the recommendation of the Central Board. The volume of these Indian securities is however, subject to a two-fold limit. In the first place, the aggregate value of Indian securities must not exceed the capital and reserve of the Bank plus 3/5ths of the deposit-liabilities of the Banking Department. Secondly, the value of securities maturing after one year and of those maturing after 10 years should not exceed the capital and reserve of the Bank plus in the order of mention 2/5ths and 1/5th of Deposit-Liabilities of the Banking Department. In other words, of the maximum value fixed for Indian securities, the maximum allotted to the longer dated securities is smaller than the maximum allotted to the securities of one to ten years.

The predominance assigned to short dated securities is of course intended to save the central bank from serious fluctuations in values and thus maintain its liquidity. Short-dated securities are liable to be influenced less by changes or anticipated changes in interest-rates, political and social factors, etc., than by the proximity or otherwise of the date of repayment. In any circumstances, there is the certainty that on specific dates their full value will be realised.

A point less obvious is the limit placed on the total value of Indian securities and the absence of any such limit on sterling or securities of the United Kingdom. The volume of Indian and sterling securities taken together measures the extent to which the Reserve Bank can cause at any time deflation of the price and income structure of the country apart from or in addition to similar effect produced by an increase in the bank rate. While circumstances which justify a contraction of domestic currency are likely on occasions to coincide with a keen demand for remittances abroad, it is equally likely, as we have already observed, that large payments will have to be undertaken abroad without any necessity of deflation at home.* In

* Pp. 255-56

the former case, the sterling holdings of the Issue Department will be available to supplement the resources of the Banking Department. In the latter case, the sterling holdings of the Banking Department can be replaced with rupee securities without any adverse change in the "Percentage of Gold and Sterling Securities to Total Notes issued." Besides, as internal drain is not contemplated as a serious factor in our future currency management, large resources in foreign currencies must be the constant aim of the Reserve Bank.

The liabilities of the Banking Department for the four years 1935 to 1938-39 give us a good measure of the resources available to the Reserve Bank for fulfilling its obligations. These liabilities are composed of its capital and reserve, deposits of governments, compulsory and voluntary deposits of banks and items described as "Other Deposits" and "Other Liabilities." The aggregate has been in the neighbourhood of 36 to 38 crores in the first three years and has declined to 32 crores in the last year due to heavy withdrawals by banks already noted. In other words, the resources of the Reserve Bank amount to about one-third of those of the Imperial Bank of India which itself has held steadily about 1/3rd of the resources of the Indian Banking system.

It deserves to be considered seriously whether these resources are adequate for the responsibilities which the law lays on the Reserve Bank. It may be advisable to place the Reserve Bank in a position to enlarge or diminish its resources from time to time according to the exigencies of the situation. Suitable variations in the funds raised compulsorily from the banks themselves offer a means which has the additional advantage of affecting most directly the credit situation in the country. Under our present law, a rigid percentage is prescribed which is to hold good in all circumstances whether tending to inflationary or deflationary conditions. It may be a better device, as under the new law of the Federal Reserve System, to prescribe maximum and minimum percentages

within which the Reserve Bank could fix the operative ratio according to the circumstances of each phase. In an undeveloped money market like India, such an elastic but direct control should prove a more effective means of monetary management.

(3) The desirability of such a direct means to influence the cash position of scheduled banks appears more obvious when we take into account the capacity and organization of the market in which these operations have to be piloted. The total membership, active and inactive, of the Bombay stock exchange is about 450 as against 1100 in New York and 4000 in London. The aggregate volume of transactions is of a comparable order. An endeavour to unload large stock of short term or long term assets cannot but have serious consequences for the whole financial and investment mechanism. The difficulty is no doubt partly overcome by including in our assets foreign claims which link our currency management with the largest and most stable market of the world, namely, London. But it is not and cannot be altogether obviated.*

The assets of the Banking Department reflect the present conditions in the money market. As pointed out above,† rediscounts and loans to scheduled banks hardly exist. Balances Abroad and Investments which include cash and short-term securities represent the bulk of the income earning assets. On account of easy conditions, the Bank has refrained from holding more than a minimum volume of funds in investments. About 3/4ths of the total liabilities are mere notes which, as noted, were first equated to the deposits of scheduled banks held by the Reserve Bank and variations in which under certain conditions may be interpreted as reflecting the currency operations of the Bank.‡

* See also foot-note * p. 394 & pp. 405-406 The ordinary turnover of government securities on the Bombay Stock Exchange per day is estimated at 20 to 30 lakhs. Actual deliveries amountto 5 to 10 lakhs.

† See p. 268.

‡ P.p. 262-66

Direct Relations with Trade and Commerce

It is clear from the foregoing description of the business of the Reserve Bank that its normal relations are with the scheduled banks only and that it is not permitted business relations which will mean competition with other banks in the country. The difficulties created by such competition in the way of the national leadership of a central bank have been already analysed and assessed in our study of the Imperial Bank of India.* It has been made clear there that they are not altogether insuperable and that historical environment and tradition are powerful factors in reconciling commercial and central banking functions. Moreover, 'we must take account, on the other side, of the special circumstances of India which make bank-rate or open market policies on orthodox central banking lines much less efficacious than elsewhere. The diversity of interest-rates in several parts of the country,† the absence of a money market which may respond quickly and sensibly to central bank policies‡ the vast territorial extent of the country over which monetary impulses released from a few advanced centres have to travel, a banking structure in which numerous small banks scattered all over the country¶ must remain for a long time outside the orbit of the Reserve Bank—these are obstacles which a central bank acting through a few scheduled banks may not succeed in over-mastering.

To this general statement of the relationship between the Reserve Bank and ordinary commercial banks, the Act makes one exception. On the authority of the Central Board and, in cases of special urgency, a Committee of the Board or the Governor, the bank is allowed to engage in business directly with individuals or firms and purchase, sell or discount bills or make loans or purchase and sell sterling on same conditions as in the case of banks but without their intermediaryship. The sanctioning authority

* See pp. 86-91

† See pp. 56-71

‡ Pp. 268 onwards.

¶ See pp. 81; 84-85; 140-141

must, however, satisfy itself that the occasion of departure from normal practice is a special one and that the departure is required for the purposes of regulating credit in the interest of Indian or Burman trade, commerce, industry and agriculture.

It is clear that the power is intended to be used only in very exceptional circumstances. Even then, the precise object of its inclusion is not easy to discern. An important precedent of this kind occurred in the United States when the Relief Emergency Act of 1932 and Act of 19th June 1934 conferred similar powers on the Federal Reserve System. But these measures were adopted in the United States at a time when ordinary commercial banks had ceased to function and as a matter of fact the acts proved dead letter from the very moment of enactment. The Indian Act does not look to the Reserve Bank to fill the void of ordinary banks but to regulate credit amidst a system of functioning banks. It is reasonable, therefore, to presume that this power is intended to supplement, when necessary, its efforts to control credit in the ordinary way. If this interpretation is correct and the Reserve Bank in course of time creates many branches, this clause may open the way to a gradual but moderate super-imposition of commercial functions on strict central banking functions. Whether the future development will tend towards the model held before us by the Banque de France or the Bank of England will depend as much on the leadership supplied by the executive of the Reserve Bank as the strict letter and interpretation of the law.

Reserve Bank and Banking Standards and Practices

The control of currency and credit envisaged in the Act and elaborated above places the Reserve Bank in an excellent position to exercise steady pressure on individual banks in favour of better banking policies and practices. For, ability to offer assets conforming to conditions of legal eligibility is not by itself an unqualified assurance of aid from the central bank. The latter has necessarily to take

account of the general position of the applicant and to make it reasonably sure that such aid proves an effective means to ward off its difficulties. Such discretion assumes special significance in times of general difficulty when discrimination has to be made between banks whom aid from the central bank could save and others whom no aid of whatever magnitude could rescue from their fate. Funds placed at the disposal of the latter mean merely subsidies towards the relief and profit of the more astute or impatient creditors while banks with much better prospects of solvency are perhaps starved of well-deserved aid. The exercise of such discrimination could be based however only on continuous contact with and ample information from the banks concerned and their willingness to act on the advice and guidance of the Reserve Bank. Such information and analysis are of special importance in India where, as we have amply demonstrated, the balance-sheets of banks are more remarkable for their disparities than approximation to any standard pattern. Each bank is a special case to be understood and appreciated only by due regard to its special circumstances and particularly to its past history and development. At present the usefulness of the Reserve Bank is limited by two circumstances. The Bank has no powers to obtain information or enforce inspection except in so far as the banks themselves are willing to co-operate. The consequence on at least one occasion has been that when difficulties did arise, the time available for ascertaining facts proved too short for any definite or large decisions.* Secondly, the influence and pressure of the Reserve Bank are confined at present to scheduled banks as defined in the Act. Banks which need much supervision and nursing most are outside the purview of the Bank and no means has yet been devised to bring them within its orbit. Our proposals for a deposit insurance scheme to cover these banks should remedy this deficiency in the present situation.†

* A model for such power would be Sec. IV of the U .S. Federal Reserve Banks Act. See also pp. 345-346

† Pp. 328-31

Definition of Scheduled Banks

According to the present notification under the Reserve Bank Act, banks which have not less than Rs. 5 lakhs capital and reserve can alone be scheduled to the Reserve Bank. The deposits of these banks which number 56 at present form the overwhelming bulk of the banking deposits of the country—to the extent of 95 per cent. and more. Yet there is some oddness about a situation in which the Banking Law of the country aims at 1 lakh as the minimum capital and reserve of a bank while the condition of scheduling to the Reserve Bank is fixed by another law at 5 lakhs and more. It is quite conceivable that in the rural conditions of India, banks with capital and reserve of less than 5 lakhs have as important a role to play in the future development of its economy as banks with more imposing figures of capital and reserve.

It is necessary to bear in mind as a preliminary point the precise advantages of inclusion in the schedule. A scheduled bank is not entitled as such to rediscounts or loans from the Reserve Bank. It has to qualify for such aid by satisfying the Reserve Bank about its soundness and stability. It may even have to bear some loss if and to the extent that, its compulsory deposits with the Reserve Bank are in addition to and not a part of, the reserve it is accustomed normally to maintain. The advantage it gains really lies in its prestige in the public mind. Although a part of the prestige is ascribable to quite erroneous beliefs on the part of the public about the implications of scheduling, it cannot be denied that affiliation to the Reserve Bank carries an assurance that the bank is at least in outward conformity with the law and accepted decencies of the banking business. It is needless to add that the Reserve Bank undertakes no guarantees about the solvency or competent management of its scheduled banks.

It should not be difficult to reconcile the legitimate object of scheduling to the Reserve Bank the more respectable and important banks only in the country with a due solicitude for the growth and encouragement of the smaller banks. Apart from the size of resources, the period of existence of

a bank is one among other indices of its inherent strength. Our analysis of bank failures shows* that more than 2/3rds of the banks which fail belong to the age-groups below 10 years while the percentage for those between 10 and 20 years is only 20. It should more than meet the requirement of stability and proved usefulness if, for banks with capital and reserve of 1 to 5 lakhs, an additional condition of an uninterrupted existence of 10 or 15 years is imposed.

Reserve Bank as Clearing House

The Reserve Bank acts as the Clearing House for scheduled banks. In the absence of such a facility, a large quantity of cash should have to move to and from and in a circumlocutory manner between bank and bank. But economy of movement and of cash is not the only or the greatest significance of such an institution. Under a system of daily and frequent clearing, an over-extension of business by any individual bank must reveal itself immediately in the clearing house at the close of each clearing. In other words, this facility and practice is a great factor in making banks move in step with each other. In a vast country with scattered banks like India, there is also another danger that cheques which are long in transit and take some days to be cleared may be treated as cash and thus become the basis of a certain degree of permanent inflation. Relying on such outstanding cheques, banks may be tempted to lower to that extent their cash reserves, the same cheque serving as a cash item to more than one bank at one and the same time. The extent of the need and importance of this facility may be inferred from the fact that the aggregate volume of cheques which passed through the clearing in 8 big centres of India in the last four years has been in the neighbourhood of 20,00 crores. The volume of deposits has varied in the same years between 250 to 260 crores.

Reserve Bank and Agriculture†

By its sheer magnitude, the finance needed by agriculture overshadows and must continue to overshadow all other financial requirements of the country. The habits and

* See pp. 289-95.
† See pp. 177-81.

practices of the cultivators no less than the social and economic institutions which govern the cultivation of land make the supply of this finance the most difficult of our banking problems. These two factors no less than the fast growing political power of the peasant masses were bound sooner or later to win a recognition for problems of rural finance in the activities and policies of the Reserve Bank. As the situation is envisaged in the Reserve Bank Act, the Bank is charged to make remedial endeavours along two lines.

The resources of the Reserve Bank are made available to agriculture under conditions which suit its requirements and at the same time ensure conformity to strict central banking principles. While bills and promissory notes against which the funds of the Reserve Bank may be obtained must relate to short-term needs *i.e.* the financing of seasonal agricultural operations or the marketing of crops only, the maturity of such bills and notes is extended as a special case to a maximum of nine months. Secondly, while the principle that the funds of the Reserve Bank can be available only for the relief of exceptional pressure on the resources of intermediary banks is strictly adhered to, the endorsement of provincial co-operative banks is given as a special case the same status as the endorsement of a scheduled bank for the purpose of purchase, sale or rediscount of these bills. As for loans and advances, provincial co-operative banks can obtain them from the Reserve Bank but on the same conditions as scheduled banks *i.e.* for a minimum period of 90 days and against government securities, agricultural paper and documents of title to goods.

The authors of the Act saw clearly that the banking problem is only a part, if not indeed a mere bye-product, of the much larger question of the reconstruction of our agricultural economy and that intensive education and investigation must form a necessary basis of all remedial endeavours. The Reserve Bank has thus got a statutary Agricultural Credit Department which maintains an expert

staff to study all questions of agricultural credit, is available to all banks and banking organisations for consultation and seeks to co-ordinate the operations of the Bank in connection with agricultural credit and its relations with the above-mentioned organisations for the same purpose. The bulletins which the Department has issued from time to time bear evidence to its research and collation work while the work of making ideas and experiences of different parts of the country available to other parts is also understood to reach impressive proportions.

Without committing the Reserve Bank to any further action, the Act required the Bank to make to the Central Government a report on two specific matters, the extension of Reserve Bank facilities and obligations to persons and firms, not being scheduled banks and the improvement of machinery for dealing with agricultural finance and methods for effecting a closer connection between agricultural enterprize and the operations of banks. The former subject obviously relates to the future status of money-lenders and indegenous bankers in the country which we have already examined elsewhere.* The report was issued in due course and along with the bulletins embodies the conclusions of the Reserve Bank on the whole question of agricultural credit and indegenous banking. It points out the difficulties we have already noted about the inclusion of money-lenders and indigenous bankers within the organised banking structure of the country, particularly their unwillingness to shed non-banking business and adoption of modern accounting and banking practices. In regard to the co-operative movement, it develops a case for a radical reconstruction of the whole structure. While overdues are scaled down and passed on to long term credit institutions, and co-operative credit societies restrict themselves in future to crop loans repayable out of the harvest or intermediate credit in a limited measure, an endeavour should be made to enlarge the functions of these societies so that they cover the whole life of the farmer *i.e.*, become multi-purpose

* Pp. 177-80.

societies. The financing agency is to consist of two stages, banking unions for small areas with radius of 7 to 8 miles and provincial co-operative banks. Strict observance of business and banking principles, highly trained staffs, etc., are other directions in which improvement is urgently necessary. As for money-lenders, while supplanting them is not possible, regulation of their business by laws is suggested.

Reserve Bank in Action

The creation of the Reserve Bank of India coincided with continued low interest rates with certain unmistakable symptoms of revival of economic activity. The bank rate which stood at 6 or 7 per cent. for more than 9 months in 1931 had then fallen to a steady level of 3½ per cent. and the Reserve Bank reduced it in November 1935 to 3 per cent. at which it is maintained till today. The scheduled banks have found themselves with such surplus funds that the concentration of their reserves in the Reserve Bank and the greater sense of security implied in the assured access to the Bank in case of need are not yet reflected in any marked way in a lowering of their cash ratios. Nevertheless, it is doubtful whether the revival of economic activity such as it has been for the last three years and more could have taken place without the usual seasonal fluctuations in rates but for the existence of the Bank. A comparison of the range within which the cash of the Imperial Bank on the hand and the notes held in the Banking Department, deposits of banks, and assets of the Reserve Bank on the other, have moved, makes clear the influence of the Reserve Bank in eliminating the evil of seasonal extremes in interest rates.

Reserve Bank.

(Range of variation in crores.)

	Notes held in Banking Department.	Deposits of Banks.	Loans, Advances and Bills.	Deposits of Govt. Loans and Advances to Government.
1936 August June ...	27.42	......	......	......
1937 August April ...	19.76	Aug-Feb. 22.69	.05	......
1938 August January ...	20.45	Aug. Jan. 12.34	7.97	6.42

	Imperial Bank.			Reserve Bank.			
	Percentage of Cash to Deposits.	Range of Variation of cash (crores)	Loans Advances. Bill to Deposits (percentage).	Notes held in Banking Department and range.	Deposits of Banks.	Loans Advances and Bills (Last Friday).	Deposits of Government, Loans and Advance to Government, (Average of Friday figurs)
1931-35 (ave)							
June	25.2	...	37.9	...	...	...	...
Decem.	23.7	...	35.1	...	...	...	...
1936 June	25.0	...	32.6	31.70) 14.86	...	...	...
Decem.	10.8	11.20	33.9	16.92)	...	...	...
							0
1937 June	26.0	...	36.2	17.49) 13.63	26.51	...	4.9
Decem.	16.5	8.25	36.2	31.12)	24.36	...	...
1938 June	20.0	...	42.6	40.38) 21.90	18.10	2.10	10.2
Decem.	11.0	7.28	46.9	18.42)	12.17	...	...

Between 1931 to 1935, the usual seasonal variations in the percentage of cash to deposits of the Imperial Bank almost disappeared. In the next three years, the June and December disparity of cash ratios makes its re-appearance on almost the pre-Depression scale. The corresponding seasonal change in the volume of bills, loans and advances is not marked till 1938 which is to be explained by the secular changes which were taking place in the Imperial Bank's volume of investment.*

The seasonal demand for currency finds its expression in the balance-sheets of the Reserve Bank in this manner. In the balance-sheet of the Issue Department, while the annual average of notes held in the Banking Department is more or less stable, there is a large consistent seasonal fall in June as over August. This fall is distributed on the liabilities side of the Banking Department as a fall in the deposits of the scheduled banks and on the assets side of an increase in the discounts and loans granted to them. Similar changes in the figures relating to government operations have to be taken account of in tallying changes in notes and coin of the Banking Department with other changes.

The difference between the maximum and minimum of notes held in the Banking Department in any year measures

*See pp. 93-95; 114-118 Table XII.

the seasonal pressure for funds which the Reserve Bank has met without any change in its rate. These figures may be compared with the average seasonal difference of 12 crores in the cash of the Imperial Bank in the years 1921-29 and the large variations in seasonal rates which occurred.* The much large variations in the case of the Reserve Bank even in these years of low prices and moderate business activity and the size of the average cash balances of the Imperial Bank which stood in the neighbourhood of 30 crores indicate that but for the creation of the Reserve Bank, the old variations in the rates of interest might have established themselves again.

In the second sets of figures, a comparison is instituted between the variations in June and December of the cash balances of the Imperial Bank and the notes held by the Reserve Bank in the Banking Department. In 1938, a fall of about 7 crores in the cash balances of the Imperial Bank contrasts with the fall of about 22 crores in the notes of the Banking Department. These figures illustrate how the main burden of seasonal pressure is supported by the Reserve Bank while the banks which participate in that finance bear it to a smaller extent by lowering their cash ratios. It is evident that the Reserve Bank is playing a great and effective part in the elimination of seasonal extremes in rates which cannot but have far-reaching consequences on the Indian economy of the future.

While it may be claimed that the management by the Reserve Bank of India of the seasonal requirements of currency and credit, discloses no ground for dissatisfaction and that this management may prove to be the herald of a new era for trade and business, it is to be recorded with regret that the same unanimity of opinion cannot be claimed for its management of the first banking difficulties of the country during its short existence. As we have noted, the failure of the Travancore National and Quilon Bank created an undoubtedly dangerous situation in South India. In the restoration of confidence, the Government of Madras exercised a decisive moral influence which won a well-

* See pp. 96-98.

deserved recognition in all quarters. The Government of India, while it maintained a close contact with and presumably offered advice and opinion to the Reserve Bank, preferred, like the Greek wife of yore, to be heard of neither for good nor for evil. It is fortunate to have to record that the activities of the Reserve Bank to whom belonged the natural direction and leadership of the situation did not evoke the degree of confidence and approbation which are so much to be desired particularly in the early years of its existence. Responsible bodies like the South Indian Chamber of Commerce and the scheduled banks of Madras blandly complained of failure of expected aid and the latter could not see any justification why, in the circumstances, they should be required to place their balances with the Reserve Bank.

Difficulties seem to have begun when, before the suspension of the bank, the Reserve Bank insisted on an investigation as a preliminary to any aid. True, the investigation was intended to cover only the bigger loans and items in the balance sheet. But it was pointed out on behalf of the bank that the news of such an investigation could not be suppressed and was bound to precipitate the very evil which it should have been its object to avoid. When the Travancore Bank ultimately agreed to an investigation just a little before the final end, it was too late for any succour.

It is difficult not to concede on point of principle the validity of the position taken up on this point by the Travancore Bank. The proper time to satisfy itself on the general position of the bank was not when the bank was actually gasping for breath but in the course of the preceding three years during which it was on the list of scheduled banks. It could not be argued either that the existence of the Reserve Bank had been too short to permit of the accumulation of sufficient material on which to base its policy and decision. Only two years before the crisis, the Reserve Bank had granted the ill-starred bank a substantial credit-line to enable it to put through its amalgamation scheme. It would be hardly proper to pre-

sume that this offer was made without adequate preliminary inquiry.

The Reserve Bank was on firmer ground when it insisted that assistance could be given only against assets which were segregated and clearly assigned to the bank. This difficulty was inherent in the native state domicile of the bank which meant difficulties in case of suspension as to assets which could be availed of by British India creditors and those which might be claimed and seized by Native State creditors. The Reserve Bank was justified in assuring the absolute safety of its funds. Its stand is not so free from doubt when it claimed that the situation had altered in principle because the T. N. & Q. Bank had withdrawn the greater part of its legal reserves with the Reserve Bank. So long as the T. N. & Q. Bank paid the prescribed penalty interest, the Reserve Bank Act was not intended to prohibit and did not prohibit such withdrawals. Besides, it could not be gainsaid that the withdrawals were the unavoidable sequel to the refusal of the Reserve Bank to give any aid except after a preliminary inquiry. Again, central bank aid should have no relevence to the volume of compulsory reserve lodged with it but only the general position of the bank and the volume of its realisable assets. If aid were to be limited to the volume of compulsory reserves, scheduled banks might as well keep their balances with themselves and forego the dubious advantage of affiliation.

Certain difficulties of purely legal interpretation also arose in the course of the crisis. It was held by the Reserve Bank that demand promissory notes could not fall within the category of bills of exchange and promissory notes maturing 90 days from the date of purchase, etc., which alone the Bank was authorised to deal in. With reference to Section 17-4d, the Bank held that the documents of title to goods and not the goods themselves should have been transferred to the borrowing banks and should support the promissory notes which were to be the basis of Reserve Bank advances. It will serve no useful purpose to examine here the accuracy or otherwise of this interpretation. The Bank could not have acted except on the strict interpretation

of law as it existed at the time of the crisis. As a matter of future policy however, it is indubitable that the law of the Reserve Bank should be co-ordinated with the existing banking and commercial practice of the land unless the latter can and are willing to adapt them to the special requirements of central banking. It would be meaningless to postulate conditions which in fact do not and cannot exist for a long time. If warehouses and consequently warehouse receipts do not exist, it is idle to prescribe such documents as a basis for central bank assistance. The experiences of this crisis have established the urgent need of an inquiry into the kind of assets most in vogue and the incorporation of the most realisable of them in the law of the Reserve Bank as eligible paper. In a country where standardisation in such matters hardly exists, wisdom lies in defining eligible paper or security in a wide manner and entrusting it to the discretion of the Reserve Bank authorities to liberalize or make stringent its conditions of assistance according to market and economic conditions. Rigid or narrow restrictions on its powers of discount or advances is tantamount in a country like India as in the case of the United States, to legal incapacity for timely or massive action in states of grave emergency.

Reserve Bank of India.
(in crores.)

Issue Department.

Liabilities.

	1935-36	1936-37	1937-38	1938-39
Notes in Banking Department ...	27	25	25	39
Notes in Circulation ...	164	176	186	182

Assets.

	1935-36	1936-37	1937-38	1938-39
Gold Coin and Bullion ...	44	44	44	44
Sterling Securities ...	62	69	79	67
Rupee Coin ...	55	64	60	67
Rupee Securities ...	29	23	27	32
Percentage of Gold and Sterling to Reserves ...	55.6	56.5	58.7	52.8

Banking Department.

Depiosts—				
Government ...	11	9	11	14
Banks ...	27	25	25	16
Other ...	...	0.4	0.7	0.7
Capital and Reserves ...	5	5	10	10

Notes and Coin ...	27	26	25	28
Balances held abroad ...	15	18	18	4
Loans and Advances to Government	0.8	1.5	0.7	0.4
Other Loans and Advances ...	0.1	0.	0.8	0.2
Bills Purchased & Discounted	...	0.1	0.6	1.6
Other Assets ...	0.5	0.5	0.7	0.9

CHAPTER IX.

A BANKING CRISIS & MANY "BANK FAILURES."

Bank failures reported from year to year in India have not the same significance as in other countries with more advanced banking systems or stricter banking or company laws. Till the amendment of the Indian Company Law in 1936, no effort was made either to define the word "bank" or to ensure in any indirect way that only respectable concerns used that description in their title. The consequence was that many insignificant or doubtful ventures registered themselves as banks and when they failed, served to swell the number of so-called bank failures.

The amended Act of 1936 allows banking companies to commence business only when they have a minimum paid-up capital of Rs. 50,000. Besides, in the course of a definition which is by no means precise, a company in order to be a bank within the meaning of the Act is required to carry on as its principal business the accepting of deposits withdrawable by cheque, draft or order. The effect of these conditions will not become immediately visible since concerns which were registered as banks before 15th January, 1937 are allowed to retain that description. At no distant future, however, the statistics of bank failures are bound to undergo a profound change.

The only episode which may be described as a banking crisis occurred in 1913-14 when one Indian joint-stock bank after another met with disaster. Otherwise, bank failures of the past have been sporadic, individual failures, illustrating certain weaknesses and deficiencies to which Indian joint stock enterprize in general is prone. Epidemics such as those which have threatened to sweep off the banking system of the United States or which shook banking in several countries in the early thirties of the present century have been fortunately

almost absent. Indian banks suffer from certain endemics the extermination of which is the main problem.

Failures According to Age

Ordinarily, the long life of a bank should by itself be a proof of its good management. Failures naturally tend to be concentrated on banks which are more or less young. Two-thirds of the failures which have occurred since the banking crisis of 1913-14 are among by banks which were less than 11 years old. The proportion of failures declines very rapidly as we reach banks higher up the age-scale.

Bank-Failures Grouped by Age.

	Less than 1 year.	More than 1 yr. and Less than 3 yrs. 11 mos.	More than 3 yrs. 11 months and less than 7 yrs. 11 months.	More than 7 yrs. 11 months and less than 10 yrs. 11 months.	More than 10 yrs. 11 mos. and less than 13 yrs. 11 mos.	More than 13 yrs. 11 mos. and less than 16 yrs. 11 mos.	More than 16 yrs. 11 mos. and less than 19 yrs. 11 mos.	More than 19 yrs. 11 mos. and over.
1913-14 ...	5	26	11	2	1	3	...	2
1915-20 ...	1	7	13	6	2	3	...	11
1921-30 ...	11	54	22	11	13	5	8	19
1931-36 ...	10	72	77	19	18	23	1	18

Totals for the four periods—50; 43 143; 238.

In Percentages of Total Failures.

	Upto 10 yrs. 11 mos.	More than 10 yrs. 11 mos. and less than 19 yrs. 11 mos.	More than 19 yrs. 11 mos.
1913-14 ...	88	8	4
1915-20 ...	62	11.6	25
1921-30 ...	68	18.1	13.2
1931-36 ...	74.7	17.6	7.5

Leaving aside the crisis year 1913-14 when very few Indian joint stock banks could have claimed for themselves an existence of more than a few years, this table of mortality suggests another important inference. The proportion of failures of banks, 20 years and more old, seems to be definitely on the decline. The failures are being more and more confined to the infants and the young. As the absolute figures of failures of such banks, however, suggest this declining proportion reflects only the fecundity of the country in small and insignificant "banks."

As a matter of fact, the failures among banks, 20 years and more old, present a disturbing tale. From a qualitative stand-point, a bank 10 years old should have more

than twice the survival probability of a five year old bank. A bank which has managed to prolong its existence for more than 20 years should have more than twice the resistance power of a bank which has existed only for ten years. The failure of a bank 20 years old means much more harm to the community than the failure of 4 banks still struggling for a footing in the 5th or 6th years of their existence. Yet, our table records that 11 banks which were more than 20 years old failed in 1915-20, as many as 19 failed between 1921 and 1930 and 18 failed in 1931-36. In other circumstances, these should be looked on as highly disturbing figures.

Much of the significance of this analysis of bank-failures by age is lost when we take into account the size and character of the banks which make up these totals. We may take as an illustration banks which failed after an existence of 20 years and more. Of 11 banks which failed in the years 1915-20 after an existence of 20 years and more, only four had a capital of 1 lakh and more. Seven of them were so insignificant that nothing about them is traceable. Of the total eleven, only two deserve to be noticed as causing appreciable loss to the country or its banking system. The four banks of some size which we have referred to were among eleven which had a capital of more than 1 lakh and failed in this period.*

Between 1921 and 1930, 19 banks failed after a similar long existence and of them, only five had a paid-up capital of more than 1 lakh. As many as fifteen do not seem to have left any record behind them. Of the four about

* Bank of Upper India—(1862-1917) This bank had a paid up capital of 10 lakhs. See p. 318.

The Kayastha Trading and Banking Corporation. (1900:1920) It had a paid-up capital of 7½ lakhs. See p.

Deccan Bank— (1890-1916) Paid-up capital 50 thousand. P. Puddumjee and Co., agents, advanced money from 1897 to Gadag Spinning Co., till the loan reached 3 lakhs. On liquidation, the Spinning Company was purchased by the bank for 282 thousand and placed it under the managemenr of the nephew of the Agent A. Criminal charge was brought against the Agent but withdrawn on ground of his serious illness.

The other banks making up the list are:—

Name.	Paid-up Capital.	Place.	
Kashmiri Bank	100 thousand	Fyzabad	1882-1916
Rajdhany Bank	10 ,,	Bangalore	1889-1915
Kayastha Marcantile Banking Corporation	20 ,,	Delhi	1881-1916
Gorakhpur Bank	300 ,,	Gorakhpur	1895-1917
Chickballapur Rajdhani Bank... ...	6 ,,		1880-1917
Gudibanda Ooperhalli Shri Hanumantarayaswami Bank	Rs. 330 only		1896-1915
Jwala Prakash Meerut Bank	11 ,,	Meerut	1868-1920

which some stray information is available, the failures of two only deserve to be recorded as appreciable mishaps. During the same years, the number of banks with a paid-up capital of one lakh and more which failed runs into as large a figure as twenty-three.*

In the period of great expansion of joint-stock banks 1931-36, among banks which failed, as many as 18 could claim a prolonged existence of twenty years and more. Only 5 among them had a paid-up capital of 1 lakh and more. Information regarding only one of them is available. Those five which had a paid-up capital of more than 1 lakh were among the seven which had a similar capitalization and failed in this period.†

* Alliance Bank of Simla. See p. 313.
Bengal National Bank. See p. 301.
Allahabad Union Bank. (1904-1924) Paid-up capital 65 thousand. The manager Kedarnath Mitra gave an unsecured overdraft of 18 thousand to himself, 10 thousand to his brother, 21 thousand to his relatives and did not forget his wife who got 2 thousand. He was also the manager of Annapurna Co., which dealt in grain which was untraceable. He absconded but the directors had to make good all dividends from 1915 to the extent of 40 thousands as being paid out of capital.

Balance Sheet. (000s)

Fixed Deposits	3 Yrs.	16	Unsecured Overdraft ...	113
,, ,,	1 Yr.	62	Pro-Notes	24
,, ,,	6 Mos.	0.5	Bank's own Shares ...	0.7
,, ,,	3 Mos.	0.1	Remortgaged Ornaments	24
Savings Bank		30	Annapurna Co.	48
Family Endowment		33	Cash in hand	(Rs. 54 Only)

Poona Bank . (1898-1924) See p. 288.

The other banks were :—
Bank of Trichinopoly (1900-1921) Paid-up capital 10 thousand. Kisha Mercantile and Agricultural Bank (1901-1922) Paid capital 14 thousand. Chikballapur Kandavaradapet Sri Venkataramanaswamy Bank (1890-1922) Paid-up capital 11 thousand. Hassna Karnatic Bank (1877-1922) Capital 6 thousand. Mandya Lakshmi Vilasa Bank (1894-1922) Capital 13 thousand. Pretoria Bank (1901-1923) Capital about 3 thousand. Poona Mercantile Bank (1893-1923) Capital 124 thousand. Vellore Commercial Bank (1904-1926) Capital 3 lakhs. Gundlupet Sri Himavat Gopala Krishnaswamy Bank (1901-1926) Capital 12 thousand. Mercantile Bank, Bangalore (1892-1927) Capital 4 thousand. Gundlupet Sri Rajarajeswari Bank (1900-1929) Capital 33 thousand. Pabna Union Bank 1908-1930) Capital 30 thousand. Devanalli Sri Adinarayanaswamy Bank (1895-1929) Capital 15 thousand

† Peoples Bank of Northern India (1925-31) and Dawsons Bank which failed but was reconstructed were the only important failures. Both were less than 20 years old, the latter being founded in 1914.

Karachi Bank :—(1910-1930) With a paid-up capital of 2½ lakhs, the bank had branches at Bombay, Hyderabad and Larkana. The manager, accountant and cashier of the Bombay branch who were paid Rs .150, 130 and 110 per month respectively misappropriated bank's money and successfully concealed the facts from the branch inspector by mainpulation of accounts. A sum of 32 thousand was tapped at the account at the Mercantile Bank and signatures of constituents were forged. All were sentenced the first two to long terms. Loans to relations of directors proved another cause of bank's difficulties.

The other banks were :—Pabna Bank (1888-1930) Capital 20 thousand; Lyallpur Bank (1907-1931) Capital 1.8 lakhs; Chinese Merited Company (1909-1931) Capital 1 lakh. Trichonopoly Bank (1905-1932) Capital 32 thousand; Trinnevelly Bank (1896-1932) Capital 1.8 lakhs. Co-operative Hindusthan Bank (1906-1932) Capital 1.7 lakhs. Meerut Bank (1884-1932) Capital 60 thousand. Darbhanga Bank (1921-1932) Capital 40 thousand. Bharat National Bank (1908-1934) Capital 2.83 lakhs. Coimbatore Sabapati Bank (1913-1935) Capital 8 thousand Midnapore Bank (1915-1935) Mufassil Bank, U. P. (1910-1935) Capital 4.7 lakhs. Banking and Ornament manufacturing Co. (1906-1935) Capital 49 thousand. Lahore Bank (1906-1935) Capital 95 thousand. Hazaribag Bank (1911-1935) Capital 20 thousand. Madaripur Bank (1911-1936) Capital 10 thousand. Nanjangud Sri Nanjundeswara Bank (1885-1936) Capital 21 thousand.

The general conclusion stands out from these facts that among reported bank failures in this country, age by itself is not a significant factor. Concerns which hardly deserve to be described as banks manage to lead a charmed life for years and years and then slip out of existence.

Failures according to Paid-up Capital

It would be difficult to decide whether, among banks which have reached or passed a certain optimum size, long life or large resources are a better indication of capacity to withstand adverse times. If age were no factor to be taken account of, it is natural that mortality should be more frequent among banks with smaller resources than those with ample resources. It is unfortunate that the statistics of bank failures indicate only the paid-up capital of banks which have gone into liquidation and are silent about reserves or deposits. Basing our analysis on paid-up capital only, we find that more than three-fourths of the failures which have occurred since the banking crisis of 1913-14, are accounted for by banks with paid-up capital of less than 1 lakh. The table below illustrates the tendency of the proportion to fall as we move up in the scale of capital resources.

Failures according to paid-up capital
(when available.)

Year.	Less than Rs. 10,000.	More than Rs. 10,000 and less than Rs. 20,000	More than Rs. 20,000 and less than Rs. 30,000	More than Rs. 30,000 and less than Rs. 50,000	More than Rs. 50,000 and less than 1 lakh	More than Rs. 1 lakh and less than 5 lakhs	More than Rs. 5 lakhs and less than 10 lakhs	More than Rs. 10 lakhs & less than 20 lakhs	More than Rs. 20 lakhs & less than 50 lakhs	More than Rs. 50 lakhs & less than 1 crore	More than 1 crore.
1913-14 ...	12	4	4	5	8	7	3	2	...	2	...
1915-20 ...	15	4	1	5	8	1	2	...	...	...	...
1921-30 ...	40	15	4	11	11	11	6	3	...	2	1
1931-36 ...	95	28	14	13	12	7	2	...	...	...	...

	Summary Table.			In percentages of total failures.		
	Less than 1 lakh.	More than 1 lakh and less than 5 lakhs.	5 lakhs and more.	Less than 1 lakh	More than 1 lakh and less than 5 lakhs.	5 lakhs and more.
1913-14 ...	33	7	7	70	15	15
1915-20 ...	31	8	3	74	19	7
1921-30 ...	81	11	12	78	10	12
1931-36 ...	157	7	2	94.5	4.2	1.3

The first and third periods show a high percentage of failures among the biggest banks. The failure of 7 banks with a paid-up capital of 5 lakhs and more in a total of 47 in 1913-14 should not cause any surprise. The panic of 1913-14 started with the fall of one of the biggest Indian ventures and spread to all other banks. A panic does not discriminate in its victims.

The failure of 12 such banks among a total of 104 during 1921-30 stands on a different footing. Among the victims were the Alliance Bank of Simla, the Tata Industrial Bank, the Calcutta Industrial Bank, Trust of India, Industrial and Exchange Bank of India, Bengal National Bank, Bombay Merchants Bank, the Bank of Morvi, Indian Industrial Bank and two private concerns connected with the House of Petits in Bombay. Most of these failures have been analysed elsewhere.* It is clear that in every case the failure was an individual misfortune, more than deserved in most cases by long and recalcitrant mismanagement. No evidence is forthcoming to prove that these years presented any exceptional difficulties to Indian banks as such.

The rate of annual suspensions of banks indicates that failures among the bigger banks are gradually declining with the progress of years. The rate we have calculated is not exact since for banks in liquidation we have figures only of paid-up capital while for banks in existence at the commencement of each period, the figures take account both of paid-up capital and reserves. Banks with paid-up capital only of Rs. 1 lakh and more must be considerably less than banks with capital and reserves of the same magnitude. In other words, the rate calculated understates the mortality from period to period. But this discrepancy is not likely to alter the trend of things as such.

	Banks in existence at commencement of each period. (Capital Rs. 1 lakh and above.)	Total banks in liquidation.	Rate of Suspension per annum.
1913-14 ...	41	47	17.0
1915-20 ...	45	42	4.0
1921-30 ...	65	104	3.5
1931-36 ...	84	166	1.8

* See pp. 163-164 foot-notes.

The striking discrepancies of the first two columns prove the great, almost overwhelming share of the small banks in "bank-failures" in this country. The growing stability of the bigger banks is well demonstrated by a consistent decline in the rate of annual suspensions.

We shall now present an account and analysis of some of the bank failures which are representative and indicate certain broad inferences and conclusions. An effort is made to group the failures according to the main causes which appear to have brought them about. In every failure, of course, many causes have been at work; in some, one cause may have called into existence others and it is not altogether feasible to reconstruct the chain of events. Still an arrangement of this kind is much to be preferred to a chronological account as facilitating the review of the whole problem which is the subject matter of the next chapter.

Lax Laws, Public Ignorance and Bad or Dishonest Management

Among many wiles employed to beguile the public into placing their funds with banks, none was more crude or more frequent than the advertisement of imposing figures of authorised or subscribed capitals as against very fractional amounts of paid-up capital.*

Poona Bank, Poona.—This bank was founded in June, 1889 and went into liquidation in August 1924. There is little in its balance sheets to justify its marvellously prolonged existence. It took full advantage, however, of the banking boom before 1913 to tempt into its coffers deposits 9 to 10 times its paid-up capital. At a time when its paid-up capital was little more than 3 lakhs, an advertisement in the leading English daily of the province announced its authorised capital as 10 crores and its subscribed capital as 50 lakhs. While Rs. 85 per share of 100 were still uncalled, it even issued new shares to bring

* Pp. 860-864

more grist to its mills. The crisis of 1913-14 denuded the bank of the bulk of its deposits and it never recovered thereafter.*

Amritsar National Bank.—This bank had a very brief but apparently bright career from January 1922 to May 1923. Within that amazingly short period of time, it collected deposits equal to about 12 times its paid-up capital. Its authorised capital was advertised as 50 lakhs and subscribed capital as Rs. 10 lakhs while the capital actually paid in was Rs. 160 thousand only.

To create or merely to advertise a large number of branches was a common device which promised a double advantage. It created a sense of imposing size or enabled the banks actually to spread their talons far and wide.

The Pioneer Bank.—This Bank which we shall notice again presently had a paid-up capital of about 2½ lakhs and deposits of about 3 lakhs. In its advertisement in the Press, it promised the public that branches were to be opened in London, Paris, New York and 31 places in India "as soon as certain arrangements were completed."

The Hindustan Bank, Multan.—This bank was founded by Mr. Daulatrai brother of Mr. Lala Harkishen Lal in July, 1906 and went into liquidation in January, 1914. At one stage, its authorised capital was increased from Rs. 2½ lakhs to 10 lakhs but the paid-up capital remained unchanged at 120 thousand. Within the short space of six years, as many as 36 branches were created and the amount of deposits was inflated to above Rs. 10 lakhs.

Kathiawar and Ahmedabad Corporation.—This bank established in June 1910 and liquidated in December 1913 took evident pride in its authorised capital of 50 lakhs against paid-up capital of 7 lakhs and odd. In its brief

* Poona Bank. (000 Rs.)

		Subscribed	Paid-up	Reserves.	Deposits.
1907-08	...	20,00	60	85	590
1910-11	...	"	330	66	2,590
1911-12	...	"	330	70	2,000
1914	...	"	900	100	1,010
1915	...	"	900	108	470
1916	...	"	900	200	240
1920	...	"	600	71	120
1923	...	"	600	120	255

career of two years and a half, it created about a dozen branches in India and one more in Nairobi. On its failure, the wily shareholders in Ahmedabad did everything to frustrate the depositors and creditors of the Bank who unfortunately for them hailed largely from the Punjab. When the Court ordered compulsory liquidation, the shareholders tried to evade the rigorous inquisition by pleading for voluntary liquidation. The auditors of the bank avoided to report and the auditor appointed by the Court could not obtain access to the relevant material!

The adoption of similar or imposing names was another bait offered to the ignorant or ill-informed public. There was launched in Delhi in February 1913 a bank by name Imperial Bank. Its authorised capital was Rs. 10 lakhs, subscribed capital 40 thousand and paid-up capital about 8 thousand! Luckily, it disappeared in October 1914. Otherwise, the christening of the three amalgamated Presidency Banks might have raised a nice difficulty seven years later.*

The fact is that the very word "bank" has a connotation for the ordinary man which proves his siren song of disaster. Even before the outbreak of the banking crisis of 1913-14, the danger was quite felt and realised by the Government. "Poor and uneducated people" the Finance Member of the Government of India said in March 1912 "are attracted by the word 'bank' thinking that it necessarily implies security and stability; and unscrupulous persons accordingly apply the term to speculative business in order to attract investors and depositors." But the Finance Member could think of no remedy, legal or otherwise. He contented himself with declaring that the Government of India might well hesitate to rush in "where more experienced legislators fear to tread." The consequence was the banking panic of 1913-14, any remedial

* In the Bombay High Court, Mr. Mulla J. recorded an interesting judgment in 1922 restraining the National Bank of Indore from carrying on business under that name on the action of the National Bank of India. Leading brokers gave evidence for the plaintiff bank. It was held that the question in such cases was not whether the intelligent section of the public was likely to be deceived but whether the public at large was likely to be deceived. The following dictum of Sir G. Jessel, 50 L. J. ch. 355 was quoted with approbation. "The public are careless and it is no use supposing that if they paid a moderate attention to names they would see they are not the same but only similar."

Commerce. 9th September 1922.

action being deferred even after that on account of the outbreak of the Great War.

As one peruses the doleful tale of bank-failures in India, one wonders whether the ignorance of the public was not equalled and indeed exceeded by that of the worthy bankers who set out to endow India with a great banking system. Undoubtedly fraud, there was in plenty and in quite despicable forms. Yet, it is more probable that in many cases, ignorance in very naive forms was more responsible for the misfortune of Indian banks.

The British India Bank.—This bank was established in April 1911 and for two years before it was formally liquidated in September 1913, it seems to have become somnolent. Its authorised capital was Rs. 250 thousand while its paid-up and subscribed capital was Rs. 6 thousand only. In less than a year of its establishment, its boasted of 3 branches and 17 agencies in " all towns, cities, trade-centres throughout British India."

The promoters of the bank who elected Allahabad for their operations adduced certain very forceful reasons to overcome the traditional timidity and suspiciousness of the investors. " Unlike concerns in which machinery has to be purchased and buildings have to be erected, and the money of the investors has to be idle for a considerable period." They pointed out in their prospectus " in the banking business, money is invested in some other profitable venture from the day it is paid in and the shareholders and depositors can always expect quick and good return on their investment. The prospectus then proceeded to unfold the many and varied services which the bank aspired to bring to the doors of the public. It undertook to offer " sound and proper advice . . . . . concerning investment of any class." " It was prepared to effect all classes of insurance as agents for the leading Life, Fire, Marine and Accident Offices." It would " engage passages to any part of the world." On behalf of its constituents, it was to undertake " to conduct business of any nature, whether occasional, special or permanent under a power of attorney."

The Sivarama Ayyar Bank, Madras.—A touch of the genuine Quixotic is supplied by this bank which went into liquidation in 1932. It was set up as a poor man's bank and true to its name, it accepted deposits of even a fraction of an anna. Among its valued customers were reported many beggars. When ultimately the bank closed down amidst exciting scenes, the ingenious Sivarama Ayyar, its founder, shareholder and manager ascribed the failure to heavy expenses of organisation and the prevailing trade-depression! During its brief and presumably bright life, it had opened branches at Madura, Trichonopoly and several other towns.

Bombay Banking Company.—This bank was established in November 1898 and after a long and apparently useful life was dragged into liquidation in the panic of 1913-14. The concern achieved reputation and confidence in certain social circles and communities because of the presence on its directorate of a highly respected and eminent medical practitioner of Bombay. It appears that the Directors gave "complete discretion to the agents of the bank." This discretion was used by the agents to give liberal loans to themselves and to prepare entirely false balance-sheets. The shareholders gratefully received their dividends of 12 per cent. and made no inquiries. A flutter of suspicion was caused in October 1912 when the manager took a trip to America and Rs. 5 lakhs were withdrawn by the depositors. The dividend of June 1913 was a modest one of 6 per cent. The bank continued, however, in an unconcerned manner as the eminent director mentioned above endorsed without inquiry or appreciation of the responsibilities he incurred thereby, all hundis submitted to him. But when panic arose over the failure, first of the Peoples Bank of Lahore, and then the Credit Bank of India at Bombay, suspension was forced on it despite courageous efforts to stave it off. The agents promptly declared themselves insolvent.

The directors seem to have then discovered the way in which the bank was managed. "As to books," observes the report of the liquidators, "the bank failed to keep even such

books as are generally kept by private banking firms. Only one day book and one ledger were maintained and the directors and shareholders appear to have been content with these two books." The liquidators express the suspicion that "the registers of securities and pro-notes were suppressed."

The Pioneer Bank, Bombay.—Established in September 1911 by Rahim Joosab, the brother of the much more well-known Jaffar Joosab, manager of the Credit Bank of India, the bank was finally liquidated in December 1916. With an authorised capital of Rs. 50 lakhs and subscribed capital of about Rs. 15 lakhs, it collected a paid-up capital of about 2½ lakhs and deposits by 1913 of about 3 lakhs. Most of its paid-up capital was bogus. Moneys which were paid in as subscription to the bank's shares were loaned out to the same parties against those very shares. Persons in financial difficulties were invited and given loans part of which was retained as application money for Pioneer Bank shares. When petitions were presented for winding up on these grounds, it was held that these grounds related to the internal management of the bank and did not fall under any one of the five heads stated for the purpose in the Indian Companies Act.

The Credit Bank of India.—Established in December 1909 with an authorised capital of Rs. 100 lakhs, subscribed capital of Rs. 50 lakhs and paid-up capital of Rs. 10 lakhs, the bank started in Bombay the epidemic which had broken out in the Punjab with the collapse of the Peoples Bank of Lahore. The Credit Bank achieved among other things an unusual distinction for gathering within its fold men who were quite untrained for the responsibilities entrusted to them. On appointment as manager of the bank, Jaffer Joosab pleaded ignorance of banking or accountancy and requested the Directors to give a strong committee to assist him. Till the day of the collapse of the bank, he had not grasped the meaning of a bill of exchange. When asked to account for Rs. 5 lakhs out of a total of about Rs. 7 lakhs shown as current accounts, he made the following confession. "That was made up of mere paper entries; Mistry taught

me this window-dressing and said it was not illegal and many banks were doing it . . . . The account and balance-sheets were prepared by my staff under instructions from the auditor." The chairman of the Board of Directors was in no happier situation. "Before I became acquainted with the bank" he admitted "I had absolutely no knowledge of finance or banking, nor have I any now." Mistri, the auditor pleaded ignorance as defence for every omission or error pointed out in the course of the trial.

The Bengal National Bank.—The Bengal National Bank was one of the few outstanding institutions which resurgent patriotism created in the eventful years 1906-07. Throughout its career, it adhered very strictly to the initial resolution of the founders to exclude all foreign element from the management. Inexperience of banking, however, was more than offset by a very overcautious policy in the initial years of its existence. As late as 1913, the balance-sheet discloses a high amount of Rs. 5·1 lakhs as cash on hand and at bankers against a total deposit liability of 24·8 lakhs. The ratio of working expenses to total resources was not too unfavourable while the temptation to declare high dividends was firmly and consistently resisted.

	Dividend per cent.
1908	nil
1909	1
1910	1
1911	4
1912	5

There had been difficulties in 1913-14. In 1917, a litigation caused a severe fall in deposits from Rs. 25 lakhs to Rs. 2·7 lakhs. But the bank recovered steadily from these disasters till by 1923 its deposits exceeded Rs. 80 lakhs.

Unfortunately, more permanent causes were slowly undermining the strength of the institution. Patriotism by itself is a poor substitute for business ability and vigilance. Sooner or later, it serves as a convenient cloak in the hands of unprincipled men in which all walks of life and particularly business always abounds. The bank became

gradually a family concern. Young men without any qualifications found themselves in responsible positions simply because they were connected with the promoters and organizers of the bank. Five out of six directors became heavily indebted to the bank. One of them alone obtained a loan of Rs. 3 lakhs against no security of any kind. Two of the moving spirits made it their special concern to obtain unsecured accommodation for a host of their friends and associates. Most of the bank officers were contented to have overdraft accounts for themselves without any security or with insufficient security. The auditors were not forgotten; they received generous accommodation from the bank.

With deposits of Rs. 81 lakhs, unsecured loans reached the astonishing figure of 50 lakhs while industrial concerns of very doubtful character received by way of loans as much as Rs. 25 lakhs.

A severe warning came in 1923 when with the failure of the Alliance Bank of Simla a run on the Bengal National Bank drained away as much as Rs. 24 lakhs out of deposits aggregating to Rs. 85 lakhs. The Imperial Bank of India came to its aid with two loans amounting to Rs. 20 lakhs against the liquid assets of the bank. The warning either came too late or was not heeded. On March 31st 1926, the bank issued the following astonishing balance-sheet.

(figures in lakhs.)

Liabilities		Assets	
Capital	8·0	Fixed Assets ..	·01
Reserve Fund ..	2·5	Bills and Loans	112·0
Contingency Fund	0·7	Securities and Investments ..	1·6
Deposits ..	81·0	Cash	3·8
Sundry including profit and loss ..	25·0		

The bank now developed an extraordinary technique of returning cheques on flimsy excuses while men of straw were alleged to be still receiving overdrafts. Withdrawals began in April 1927 and culminated in the closing of the bank. It was estimated later that not more than Rs. 60 lakhs worth assets were recoverable.

A criminal prosecution brought to a close this inglorious history. The auditor whose criminal compliance was responsible for the postponement of the evil day for a long time, the director and managing director who were the real culprits in this abuse of public trust were all sentenced to long terms of imprisonment.

Dangers of Industrial Finance

In another chapter, we have analysed the implications and present position of finance of industries out of banking funds. From very early days, public opinion in India stimulated by the spectacular economic success of Germany and Japan has been overwhelmingly in favour of mixed banking such as prevails in these and other countries. It is hardly surprising that this opinion should have reflected itself from time to time in ventures along these lines. Unfortunately, it is not clear whether the public, most concerned with such ventures, has begun to appreciate even now the limitations, precautions and technical conditions presupposed in their successful working.

The Peoples Bank of Lahore.—This bank was established in February 1901 with an authorised capital of Rs. 35 lakhs and subscribed capital of 22 lakhs. It closed its doors on 19th September 1913. The magnitude of its resources was by itself sufficient to make its failure a major event in the world of Indian banking and finance. Unfortunately, its disappearance acted as an immediate provocation to a widespread outbreak of distrust which had been gathering force slowly in the previous few months. In the rapid succession of failures which now ensued, the panic-stricken public lost all sense of discrimination and each bank which failed was judged by the standards applicable to the worst of them.

In the case of the Peoples Bank of Lahore, there was less justification for such an attitude. The object of the bank was stated very clearly in its memorandum of association. The bank was founded to promote and maintain industrial enterprises on "swadeshi" lines. In an early report, the

directors were quite explicit. The report ran "Our managing director, Mr. Harkishen Lall having espoused the cause of industries in the Province, the directors agreed with him in investing funds in industrial concerns in preference to land mortgages or trade-hundies."

The following balance-sheet published three years before the collapse of the bank may be compared with the principles and practices of mixed banking we have already analysed.*

31 December 1910.
(figures in lakhs.)

Paid-up Capital	11·5	Cash-credits, bills, pro-notes, overdrafts	79·3
Reserves	1·8	Deposits with other banks	2·4
Deposits	98·4	Drafts in hand	1·9
		Debentures and other Investments	4·2
		Govt. Paper	4·2
		Cash in hand and at bank	7·1

The circumstances in which the bank undertook to aid or initiate industries in this country were in no way favourable. Industries were either conspicuous by their absence or in very immature stages of growth. While men made fortunes in mere trade and commerce, industrial enterprize was no where visible except in the already well established cotton and jute mills of Bombay and Calcutta. It is not surprising that the managing director of the Peoples Bank became also the promoter and manager of several enterprizes. He had the long vision also to incur much expenditure to finance Indians abroad for the study of industrial and technical subjects. The combination of banking and enterpreneurial functions need not have led the bank into difficulties if the standards of banking practice had been quite strict.

When the bank ceased to operate, it was found that 88 lakhs out of total deposits of Rs. 1 crore and more were

advanced to enterprizes in which the managing director was directly interested. The number of concerns in which the managing director exercised direct control was as high as 17. As late as 1913 the directors do not seem to have found any cause for uneasiness. In their report of that year, they even took notice of "some adverse talk about bank investments in industrial concerns." They, however, declared themselves as satisfied that all liabilities to the bank were adequately covered by properties. Unfortunately, many of the major concerns on which the funds of the bank were embarked did not prove profitable. The most important among them were the Punjab Cotton Press to which 20 lakhs were advanced, the Lahore Spinning and Weaving Mills and the Pioneer Investment Company to which 8 lakhs had been offered. The confidence which the directors had placed in the managing director was nevertheless vindicated by subsequent investigations. The report of the official liquidators could not discover any trace of an effort or intention on the part of the managing director to profit himself at the expense of the bank. On the contrary there was much in his behaviour to prove the excellence of his motives. In the ultimate result the bank paid all its creditors in full but the shareholders lost all their capital.

The Amritsar Bank, Lahore.—Along with itself, the Peoples Bank dragged into the abyss the Amritsar Bank which was deeply interlocked with it. Mr. Harkishen Lall whom his detractors nicknamed the Napoleon of Punjab Finance on account of the magnitude and boldness of his ventures had been its director till 1910 but even after his retirement continued to influence its policy in a decisive manner. In the post-mortem, it was found that Rs. 4 lakhs were advanced to Mr. Harkishen Lall in his personal capacity. Against advances of Rs. 21 lakhs more, the securities were either mere promises to pay or shares of Mr. Harkishen Lal's concerns. In the auditors report for 1911, the following significant sentence occurs. "We referred to the directors certain accounts which appeared to us to be not fully secured. The directors however hold the opinion that the

accounts are secured." 66 per cent. of the assets of the Amritsar Bank as against 56 per cent. of those of the Peoples Bank were found to be invested in the same 10 companies.

The Tata Industrial Bank.—The Tata Industrial Bank came into existence in 1917 in the very midst of the Great War amidst the glamour of the House of the Tatas and the warm greetings and expectations of the business public. The termination of war prosperity with the crisis of 1920 and hopes deferred of high dividends seem however to have induced sobriety, if not positive sickness, in the hearts of the shareholders. Within about six years of its establishment, their clamour forced amalgamation with a commercial bank, the Central Bank of India.

The following statement of liabilities shows its progress and the extent and degree to which it was qualified to undertake industrial finance.

(figures in lakhs.)

	Capital and Reserve.	Deposits. Fixed.	Deposits. Current.	Total.	Cash-balance.
1918 ...	70 + ...	228	198	488	70
1919 ...	152 + ...	415	390	871	160
1922 ...	225 + 18	419	325	905	216

In 1923, on account of the severe collapse of the post-war crisis, industrial holdings showed some depreciation and there was a loss on sterling bills acquired in times of low exchange rates.* An allotment of 11 lakhs out of profits had to be made to offset these losses. As a memorandum subsequently circulated by the general manager pointed out, purely industrial investments aggregated to Rs. 27 lakhs only. These were distributed among three enterprizes, chiefly—a bank in London by name British Italian Corporation, Tata Iron and Steel Company (second preference shares) and Bombay Electric Supply and Tramways Co. Two of these three have more than justified the choice of the manager. It was also pointed out that liquid assets accounted for about 66 per cent. of the deposits. Since more than half the deposits were fixed and the fixed capital amounted to more than 15 per cent. of the deposits, this certainly indicated a sound state of things. True, 66

lakhs had been lavished on magnificent structures in Bombay and Calcutta. Better insight into public psychology about banks and a knowledge of practice elsewhere should have perhaps reconciled the shareholders to this Indian prodigality. The management pleaded that after housing the bank, the properties were estimated to give a return of 4 per cent.

But the House of Tatas was then under a cloud. Many of its other enterprizes were yet to fulfil the investors' sanguine hopes, hopes fostered by the quick riches begotten of the war. The Industrial Bank had some interests in the Industrial Finance, Ltd., which was but another name for some Tata concerns—notably New India Assurance Co., Nira Valley Sugar Co., Tata Power Co.* In this atmosphere explanations, however valid, were of little avail.

One decisive fact stared the shareholders in the face. The profits from ordinary banking business were moderately good and consistent. The industrial side of its activities appeared to exist only to diminish these profits. Under great clamour, the directors were coerced to promise not to make further investments in industries.

When the shareholders met shortly thereafter, on 19th July, 1923 to cast 550,000 votes in favour of amalgamation as against 259 votes against it, they exacted one safeguard from the management. The directors of the new bank were required to eschew seats on the directorates of other banks. Obviously, interlocking directorates were an evil much feared in those days.

The Bank of Burma.—Interlocking interests may be unavoidable and perhaps even desirable in certain stages of industrial progress. With a high standard of business ethics, they are quite innocuous. Character and not laws are the ultimate foundations on which greatness of a community in economic as in other fields of endeavour has to rest. Yet, it is equally undeniable that laxity of law and practice is more often than not an invitation to all that is mean and unestimable in a society.

* P. 156.

The manager of the Bank of Burma fell under the power of its two directors, Messrs. Mower and Clifford. These two grabbed the funds of the bank for their own enterprises. The security of the loans consisted entirely of the shares of the companies of which the agency was with Mower & Co. Only two of these companies were paying dividends. The bank went to the length even of underwriting the shares of Mower & Co., at Rs. 21 per share of Rs. 15 nominal value. Imprudence or speculation was piled on fraud. Rs. 10 lakhs were lost on shares of Burma Investments, Ltd., and Burma Petroleum Co., but the directors would not take any notice. Even when the fate of the bank was clear, large fixed deposits were offered and accepted in the last few weeks of its existence.

It took about 10 years to liquidate the bank completely. The creditors were lucky in receiving a dividend of as much as annas 0-14-6 in the rupee while the sharesholders lost everything.

Dangers of Speculation

It is a matter for opinion whether ordinary deposit banking can be combined in a prudent manner with the finance of industry. When a bank is launched with a clear avowal of this object, no blame could rest with the organisers on the ground of misleading the public or misapplication of their funds. Very frequently, however, banks appeal to the less scrupulous as a convenient means to acquire funds which, if the object were stated clearly, would not be forthcoming at all. While many of the failures already noted illustrate this danger, the most glaring example of such abuse has yet to be recorded.

The Indian Specie Bank, March 1914.—The foundation of this bank with an authorised capital of Rs. 2 crores, subscribed capital of 1½ crores and paid-up capital of about 75½ lakhs was due to the initiative and enterprize of one man, Mr. Chunilal Saraiya. Originally a man of medical qualifications, he had had a long experience in the methods and practice of banking on the staff of the Bank of Bengal. He played a noteworthy part in the launching of the Bank

of India in 1906. He withdrew from the bank when the authorities of that bank declined to appoint him its manager. His reputation for ability and financial skill was however, so high that he attracted into the directorate of his new bank some of the most eminent men in the public and business life of Bombay. Unfortunately, events proved that Mr. Chunilal Saraiya's inclinations lay all in the direction of speculation rather than constructive business.

Very early in its career, rumour became busy that the bank had embarked on colossal speculations in silver. Authoritative notice of this rumour was taken when in the course of the fifth general meeting of the shareholders in 1911, the chairman said: "I may mention that not one ounce of silver is held by this Bank on its own account and your Board is determined to adhere to this policy." Yet, the belief persisted obstinately in the public mind. Within less than a year of this disavowal, the Commerce of Calcutta reported that "The attempt to corner silver, a project of the directors of the Indian Specie Bank still continues, and the leading spirits of the enterprize entered the market again as buyers on a large scale." In the following May, the market recorded its estimate of the success by putting up shares of the Indian Specie Bank from Rs. 52 to Rs. 66. Admirers of this species of banking were not lacking either in those quarters which should have known better. A local journal commended Mr. Saraiya with evident approbation as the manager "who forced the Secretary of State in England and the finance member in India to buy silver at enhanced rates, thus earning a profit of about Rs. 25 lakhs at a stroke."

The mode of operation of the speculators whose names, although known with an absolute moral certainty, were never officially disclosed, was neither original nor ingenious. In the list of the debtors of the bank, there appeared the mysterious firm of Mr. Nanabhai & Co., which was the fixed ring or syndicate of the aforesaid speculators. When the time for the compilation of each balance-sheet arrived, the firm used to disappear to make room for fictitious

debtors who passed appropriate promissory notes. The directors of the bank itself took good care to show their liabilities to the bank as nil. As a matter of fact, when the bank closed its doors, they had to admit a liability of Rs. 12 lakhs which they hurried immediately to pay off. The following figures set out what the trying judge describes as "a miserable tale of the lowest form of fraud, the creation of fictitious debtors and the preparation of demand promissory notes in support of these."

(in lakhs of rupees.)

	Losses	Gains
1909	22	—
1910	9	—
1911	81	—
1912	—	80
1913	78	—

Thus the bank was saddled with a net loss on account of speculation in silver to the extent of Rs. 111 lakhs, while silver worth more than 4 crores was found to have been held on behalf of the bank in London by Messrs. Sharp and Wilkinson.

The immediate cause of the collapse was the fear raised in the public mind by the fall of the Peoples Bank of Lahore in September 1913 and the end of the Credit Bank in Bombay on 1st November 1913. The Specie Bank was presumed to have common interests with the latter. Later, the manager of the Credit Bank himself admitted that large sums were represented with mutual consent as lying with the Specie Bank on behalf the Credit Bank which, in his opinion, was a legitimate form of window-dressing. The Specie Bank also held under doubtful title cotton mill shares of the value of Rs. 20 lakhs which had to be subsequently surrendered. In the run which ensued, the Indian Specie Bank paid out in cash Rs. 90 lakhs in a few weeks. The public was profoundly impressed with the promptitude and the apparent ease. Yet, more critical minds could not but notice mysterious movements in the balance sheet. The reserve fund of Rs. 15 lakhs invested in govern-

ment securities had disappeared. Deposits fell by Rs. 48 lakhs. But loans actually mounted by 30 lakhs to a figure of Rs. 2½ crores. No man could guess what the security behind these loans was. Sundries to the extent of 13 lakhs occupied an uncomfortable place in a corner on the liabilities aside.

The actual course of events, however, bore singular testimony of the confidence which the public placed in the directors and particularly the abilities and financial genius of the managing director. An insignificant shareholder alleged to have been instigated by the personal enemies of the managing director presented a petition to the High Court for winding-up. It was clearly felt that the ordinary public would not be able to discriminate between the petition of a shareholder for liquidation and the order of a proper court for the same object. There took place an astonishing rally of the shareholders and directors in support of the bank. The judge unable to restrain the processes of law felt constrained to admit it with these words. "I should like to say that it struck me as a most remarkable circumstance that shareholders representing a capital of three quarters of a crore of rupees and creditors to the extent of a crore of rupees, should come forward together to support the directors and the managing director in the manful fight they have made for the existence of the bank, in spite of allegations of very hazardous trading. Not a single shareholder or contributory or creditor has come forward to support the petition."

The trading had been indeed hazardous. The loans to constituents for speculation in silver alone aggregated to 3 crores and more. 60 lakhs and more were advanced against pearls which the bank held. The pearl market had, it is true, grown brighter and brighter since the advent of the century. But, unfortunately for the bank, the two parties to whom advances had been made became insolvent just about the time of the failure of the bank. The stock exchange also had its share of the bounty. From 55 to 65 lakhs were advanced for budla transactions for which

the bank ultimately could lay its hands on shares valued at not more than Rs. 9 lakhs.

In the last eventful week of the bank's existence, heavy withdrawals occurred from Monday to Saturday to the extent of about Rs. 15 lakhs. Saturday's toll was a moderate one, about 1½ lakhs only. After a strenuous but impressively well sustained cross-examination, Mr. Chunilal Saraiya withdrew to participate till a late hour in the feast and festivities held to mark public confidence in him and the bank's survival in the ordeal. The dinner does not seem to have agreed with the hero of the episode. For, next morning, the city was petrified to hear that Mr. Chunilal Saraiya had died of heart failure. On Monday morning, before anybody else had a chance, the directors rushed to the High Court with a petition for voluntary liquidation in their hands.

The inevitable post-mortem exposed to light the following doleful history.

	in lakhs
Loss on silver speculation	111
Loss on advances against pearls ..	36
Loss on loans for budla deals	14
Loss on imprudent loans	4
Total Loss.	165

The bank had made no profits since 1909 and dividends aggregating to 22 lakhs had been paid out of capital. After all assets were realised, there still yawned a deficit of Rs. 79 lakhs against which there was the unpaid capital of the bank of Rs. 74 lakhs.

Victims of Misfortune

It would be strange if banks were more immune from sheer misfortune than any other kind of business. Banks depend for their stability on mere mass opinion to such an extent that they have more cause to fear misfortune than other enterprizes. Yet, examples of failure due to circum-

stances outside the sphere of bank managements are hard to find. A tinge of imprudence if not positive dereliction of duty is always present in almost every disaster.

The Bank of Upper India, Meerut.—The bank established as long ago as 27th June 1863 was slowly but steadily built up to a position of importance in the Indian banking world from very modest beginnings. Launched with a paid-up capital of Rs. 15 thousand only, it progressed till just before the crisis of its existence it had a paid up capital of Rs. 10 lakhs, an ample reserve of Rs. 7 lakhs and deposit liabilities of 2 crores. Confined to the Punjab and the U.P. it had created 17 branches and sub-agencies.

It was much crippled in the banking crisis of 1913-14. In the 9 months succeeding the collapse of the Peoples Bank of Lahore, the bank had to pay out Rs. 78 lakhs. Still, its investments, largely loans to Talukdars, shipping interests (Rs. 6 lakhs) and jute concerns of M. V. Apcar & Co. (Rs. 5 lakhs) were sound and, given some time for recuperation, the bank could have recovered the lost ground. But on the heels of the crisis, within a month or so in fact, came the outbreak of the Great War which proved the final blow. Securities depreciated enormously and in spite of the soundness of its assets, the bank had to announce suspension in October 1914. As the Allahabad High Court found "The present position of the bank is not due to bad management but is the result of the recent financial crisis." Both the depositors and the shareholders were repaid in full—which is indeed a striking proof of the inherent soundness of the bank.

The Alliance Bank of Simla.—This bank, one of the oldest in India, was launched into the world in 1874 and suspended payment on 27th April 1923. It fell on evil days largely on account of the imprudence of their London Agents, Boulton Bros. The Boulton Bros. initiated a policy of expansion out of all proportion to their resources. Involved inevitably in difficulties, they were unable to return a deposit of Rs. 150 lakhs which they held from the Alliance Bank. The Boulton Brothers and the officers of their firm were prosecuted in

[illegible] on various grounds including the alleged misapplication of the funds of the Alliance Bank but were acquitted. The securities held for them by the bank amounted to a mere 50 lakhs. Another debtor to the bank was the Trust of India, Punjab, which had a paid up capital of 65 lakhs and operated as a bank from 1916 to 1923. The Trust was liable to the bank for one full crore against securities which were worth only Rs. 18 lakhs. Advances against personal security amounted Rs. 180 lakhs.

In their report for 1922, the directors spoke plainly of the "knock-out blow" which the bank had sustained. This led to continued withdrawals, the effect of which may be studied from the following extracts from the balance-sheets of the bank before and after the run started.

(in lakhs of Rupees)

	1914	1921	1923 (before suspension)
Paid-up Capital	30	88	88
Reserve	40	53	
Fixed Deposits		900	498
Current Deposits		679	373
Total Deposits	554	1627	871
Cash-Balance	103	439	76

A new management made efforts to link "the bank with more powerful banking interests in order to re-establish public confidence." When the effort bore no fruit, the notice of suspension was put up.

Then, an event took place which surprised all who remembered the banking crisis of 1913-14. Directed by the Governor-General-in-Council, the Imperial Bank of India undertook to repay 50 per cent. of deposits including current accounts and savings bank deposits. The Imperial Bank was precluded from making a profit on the liquidation but at the same time it was guaranteed by government against loss. Messrs. Grindlay & Co., ran to further rescue by announcing their willingness to repay deposits of government officials.

The bank had 36 branches when it closed its doors.

BANK FAILURES

Travancore National and Quilon Bank

Most of the bank failures we have dra[illegible] tion belong to the crisis of 1913-14 while so[illegible] ones belong to the twenties of the present [illegible] now to close this account with the [illegible] Travancore National and Quilon Bank [illegible] payments as late as June 20th 193[illegible] submergence of this bank was very [illegible] occurred some time after the severest [illegible] ever known had well passed into [illegible] Secondly, it took place three years [illegible] been established in this coun[illegible] from the legal standpoint a [illegible] had however attained its [illegible] province, itself remarka[illegible] small banks.

The Travancore National and Quilon Bank, as it stood [illegible] the date of suspension, was the outcome of an amalgamation between the Travancore National Bank and the Quilon Bank. Significantly, the amalgamation had taken place only two years before the crash occurred. More significantly still, it was an agreed condition of the amalgamation that the assets of the Quilon Bank were to be taken over without any investigation. To facilitate the amalgamation, the Reserve Bank placed a substantial credit at the disposal of the two banks.

The previous history of the Travancore National Bank with its long spell of life was quite remarkable. In 1912, its paid-up capital was only Rs. 13 thousand and with deposits, its aggregate liabilities amounted to Rs. 32 thousand only. It made steady progress during the war and post-war years. By 1922, its paid-up capital and reserve were raised to about Rs. 3 lakhs and its deposits were a little short of Rs. 4 lakhs. In 1929, just before the great depression, the total liabilities were still under Rs. 18 lakhs.

Like other Indian banks, this bank seized the post-Depression years for a policy of rapid expansion—particularly by multiplication of branches. From 4 lakhs in

1930, its capital was raised to 11 lakhs in 1936 while its reserve which was a little over a lakh in 1927 rose to Rs. 3½ lakhs only. The deposits rose far more steeply due to a rapid extension of branches. Rs. 19 lakhs only in 1930, the figures were 37 lakhs in 1932, 94 lakhs in 1934 and 177 lakhs in the boom year 1936. The ratio of capital and reserve to deposits fell from 1:5 in 1930 to 1:13 in 1936.

The history and progress of the Quilon Bank were not dissimilar.

Just before the run began in April 1938, the March balance-sheet of the amalgamated banks disclosed the following situation. The situation as on 17th June 1938 describes the effects of the run just before the bank suspended payments.

(figures in lakhs).

	Apr. 1938	June 1938		Apr. 1938	June 1938
Capital ..	24	24	Cash ..	47	17
Reserves ..	5½	5½	Bills (contra)	18	15
Deposits ..	324	252	Loans and advances		
Borrowing against			i (against gold)	41	245
Govt. G P. Notes		35	ii (others)	242	
Bills ..	18	15	Investments :		
			i Govt. Securities	45	45
			ii Others	4	4
			Lands	13	14

The ratio of cash and bills to aggregate liabilities works out at 18 per cent. and of government securities at less than 13 per cent. These ratios compare unfavourably with those of the leading banks of India we have already examined.* This by itself was proof of the inflation and illiquidity of loans and advances. Investments had hardly any place in the assets of the Travancore National Bank as late as 1932 and in 1936, the date of the amalgamation, the proportion was only 11·5 per cent.

"A run on the finances of the bank" the Report of the Madras Official liquidator dated 3rd January 1939 tells us "began early in April 1938 and from that date until the suspension of payment on June 20th 1938, a sum of approxi-

* Chapter VI.

mately Rs. 1,10,00,000 was paid in satisfaction of demands made during that period." The payments made amounted to about 25 per cent. of the assets as on the date before the run commenced. "The bank had failed" continued the liquidators " (a) by reason of the fact sufficient further cash resources was not available wherewith to meet further demand for payment and (b) because the realisable value of the remaining assets on the books was very considerably less than the book values of the assets."

The run had begun in a most unusual manner. It was repeatedly alleged later that the highest state authorities had much to do in the initial creation of the panic. None can read the subsequent liquidation and reconstruction proceedings in the State and in British India without becoming aware of the vast difference between the highly surcharged atmosphere of Travancore Courts and the scrupulously objective and judicial atmosphere of British India Courts. Behind the collapse of the Travancore National and Quilon Bank, there lurks the sinister shadow of a struggle for political power between the Hindus and the Syrian Christians of Travancore. The bank was alleged to have made itself the sponsor of Christian interests and was suspected of complicity in affairs which could be no concern of a bank.

Apart from the peculiar ways and atmosphere of Native States, the failure of the Travancore National and Quilon Bank raised difficult questions of jurisdiction which must influence the future course of banking and banking law in the country.

The Madras High Court was inclined to give chance to a reconstruction scheme preferred before it. As the judge himself explained—"The scheme was propounded on the basis that if there would be co-operation on the part of all courts, where liquidation proceedings are pending and the scheme is sanctioned, it would be possible to realize 12 annas in the rupee and possibly more. I cannot say that this expectation on the part of applicants was not justified .... I cannot say ... that their action in filing the petition was not bona fide." The Court saw no cause for fearing that

other courts would not co-operate especially since it was always clear that ultimate sanction could be withheld if the scheme proved unworkable.

The first difficulty was created by the official liquidator of Cochin. He was not prepared to recognise the claims of 'foreign' creditors in the distribution of Cochin assets of the Bank. The Madras High Court was constrained to admit that if co-operation was not forthcoming for winding-up, it could not be presumed in favour of any reconstruction scheme.

The District Court of Quilon was much more explicit even to the point of undisguised hostility. Since the bank was registered in Quilon, it argued that the principal court for winding-up was Quilon Court and that a reconstruction scheme must be considered in the first instance there. It criticised severely the past management of the bank placing reliance on the report of the official liquidator in Travancore. It found the Madras reconstruction scheme "fantastic," "illusory" and "unworkable." It poopoohed the bona fides of the reconstruction scheme, stating *inter alia*, "The sponsors of the scheme were successful in no time in getting round a large body of creditors numbering about 2,400 and whose deposits amount to about Rs. 72 lakhs to file affidavits in support of the scheme .... It is said that there are High Court judges, advocates, bishops etc. among the creditors .. ... majority of shareholders (of the bank) are relatives or nominees of the directors themselves. .... the staff in the several branches of the Bank consists mostly of the relations of the directors ... propaganda in support of the scheme of reconstruction is being carried on by the ex-servants of the banks." On these grounds, the Court concluded that the creditors of the bank must be protected against their own ignorance and gullibility by ordering a winding-up.

When an appeal was preferred before the Travancore High Court, that court confirmed the winding-up order but in a manner which approached the subject from a standpoint diametrically opposite to that of the Madras High Court. The Madras High Court desired to explore the possibilities of reconstruction prior to enforcing a winding-up. The

Travancore High Court favoured winding-up since "the creditors would not be prejudiced in any manner by the winding-up order as it was open to the Court after completion of such investigation, as it might deem necessary, to take suitable steps under sections 157, 175 or 176 in furtherance of any scheme of reconstruction that might be proposed."

The whole situation was well epitomised in the attitude of the British India creditors of the Bank. In explaining their overwhelming vote in favour of reconstruction, the counsel for petitioners said before the court in Madras—"The Quilon judgment did not influence the meeting of the creditors though printed copies of the judgment were circulated to them beforehand. They could easily see the obvious meaning behind it all."

The episode illustrates forcefully the inherent difficulties, if not the impracticability of reconstructing banks once they have suspended payment. It is never easy to ascertain the realizability of certain assets—much time and inquiry are needed to reach accurate estimates. Certain incidents illustrate difficulties of investigations as such. The Madras High Court found itself unable under the law to sanction the expenditure for which the Reserve Bank wanted to be indemnified before undertaking the investigation. The District Judge of Quilon went further and described the contemplated investigation by the Reserve Bank as "an unauthorised interference with the concern of the Bank." In the case of the Travancore National and Quilon Bank the last balance-sheet had shown bad debts of 1½ lakhs only. During the proceedings on a winding-up petition, the bank authorities admitted bad debts as equal to Rs. 15 lakhs. The Quilon reconstruction scheme placed them at Rs. 40 lakhs and the Madras liquidators report at 70 lakhs. Even if all the material facts are available within a reasonable time and a bank is reconstructed on that basis, much time must elapse before deposits can be coaxed. In the meanwhile, working expenses have to be incurrd, the only source for which could be the realised assets or the willingness of creditors to accept a lower rate of interest on the dues.

A large share of responsibility for the failure must be ascribed to the incompetent or disingenuous management of the bank's business. Some of the manipulations and misleading features of the bank's balance-sheets have been already referred to above. The directors and their relatives were allowed to borrow heavily and these debts which reached Rs. 25½ lakhs by the date of suspension of the bank were not shown in the balance-sheet as such. In sentencing the miscreants to heavy fines and terms of imprisonment, the Court in Trivandrum cited grave instances of falsification of balance-sheets. The 1937 balance-sheet stated the advances to directors at about 6 lakhs when the true figure was not less than 14 lakhs. Investments in shares to the book value of more than Rs. 6 lakhs were not disclosed at all. Debts considered bad and doubtful were reduced from more than 8½ lakhs to less than 1½ lakhs. Profits of about 2½ lakhs were declared when as a matter of fact there was a gaping loss of more than 2½ lakhs to be covered even after the general reserve fund was fully utilised. These practices had been in vogue even before the amalgamation and were continued after the amalgamation. "So far as can be ascertained" the Travancore official liquidator alleged "little or no control was exercised over advances at branches and information regarding borrowers, etc., is not on record. We found that agents have very little knowledge of their duties or of business at their branches .... The management was not effective and the staff not properly trained. Account books were maintained in haphazard fashion and seldom bear evidence of having been checked or balanced while at some offices essential figures in books have been recorded in pencil." As indicated above, bad debts were systematically understated. A private and confidential circular issued on December 11th 1937 ran as follows: "To all branches. Branches shall not treat and classify any loan and advance as doubtful or bad without written instructions from this office. They are not to include any debt as doubtful or bad in the balance-sheet as on December 31st 1937 except those that have been shown in the half yearly balance-sheet as at June 30th last ......"

CHAPTER X.

BANKING REFORM AND BANKING LEGISLATION

THE main theme of the previous chapters is the growth, achievements and failures of the Indian banking system. When causes have been indicated, they relate either to internal difficulties and deficiencies of Indian banks or to their demographic or political environment which is exemplified in distribution of population, presence of foreign banks, etc. Not less important for the growth of retardation of a banking system is the state of the banking habit of a people. Banking habit is an omnibus phrase which covers economic psychology in regard to banks no less than objective economic facts and practices. To the analysis of this banking habit, the causes and forces which check or facilitate its progress, we must now address ourselves.

I.

BANKING REFORM

The absence of the habit of banking in this country is due to several causes, the relative importance and remedies of which have to be assessed separately. These causes may be placed under three heads: absence of confidence, ignorance and illiteracy of the people, and low level of incomes in general. In examining their operation, we must distinguish between fixed deposits, savings deposits and current deposits and indeed other activities of banks. For, the legal and practical obligations and requirements which arise from each class of borrowed resources and from other activities of banks are materially different in each case.

Absence of Confidence

Lack of confidence in banks as an endemic must be distinguished to a certain extent from banking panics which break out suddenly like epidemics on account of exceptional causes. Of course, the two cannot be regarded as altogether independent of each other since the known existence of safeguards against emergencies is an important

element in day-to-day confidence and the prevalence of general confidence is itself an important factor in preventing or moderating panics. The distinction made is not so much one of principle as convenience for analysis.

(a) In times of general distress and danger, such as ensue from a widespread loss of faith in the banking system of a country, it is inevitable that all eyes should turn to the government of the land for assistance and protection. It is not feasible, however, to lay down in advance the precise extent, form, manner and occasions of government intervention in such situations. The Indian Government itself has always been vague and hesitant as to the allocation of the sphere of government intervention, operation of ordinary law and law-courts and finally the prudence and wisdom of depositors in so far as these may be presumed to exist in this country. The creation of the Reserve Bank of India and particularly the discussions and controversies which preceded its creation have in no way facilitated clarification. The alien character of the government has been no doubt a factor of no mean importance in the situation as it has historically developed. But, as we shall see presently, the advance of democracy and advent of provincial autonomy have raised new problems and difficulties.

The banking crisis of 1913-14 appears to be the first occasion when the issue of government duties and responsibilities in such circumstances was definitely raised. The danger itself had been clearly foreseen both by the public and government. In a speech delivered early in 1912, the Finance Member lamented certain tendencies in the Indian banking world in these words. "Poor and uneducated people are attracted by the word 'bank' thinking that it necessarily implies security and stability; and unscrupulous persons accordingly apply the term to speculative business in order to attract investors and depositors." He then proceeded to explain how the best talents in England and elsewhere had failed to devise legislative safeguards against the abuse of the word 'bank' and concluded, "that the

Government of India might well 'hesitate to rush in' where more experienced legislators fear to tread." While ruling out direct legislative remedy in this manner, the Finance Member does not seem to have allowed his mind to be disturbed with its logical corollary that the discretionary or administrative duties of government are automatically enhanced in proportion.

When the crisis ultimately broke out, the government were constrained to admit certain responsibilities in such emergencies. Yet, as the following extract from a speech made by the then Viceroy at Madras shows, such intervenion was deemed to be sporadic and exceptional. For the day-to-day stability of the banking system, the official mind could not envisage any responsibility for itself. "We have closely followed the course of events," said the Viceroy, "and where it has been possible and legitimate to do so, we have given timely assistance. I am glad to say that there has been no undue disposition to look to Government for such help. Such help as we can properly give is limited in extent and necessarily subject to conditions and safeguards. But what we could do has been done and will continue to be done . . . If the Indian investor is taught by these events to be careful to distinguish between sound and unsound undertakings or if they pave the way to some better system of regulation and protection they will not have been unfruitful of beneficial result."* So far as banks were concerned, the concluding part of the extract remained a dead letter for two decades and more.

The next occasion on which the Government of India exercised its discretionary responsibilities to assuage distress caused by the difficulties of private banking was when the Alliance Bank of Simla closed its doors on 27th April 1923. Under instructions from the Governor-General-in-Council, the Imperial Bank undertook to pay immediately 50 per cent. of the amounts at credit of depositors including current accounts and savings bank balances. It was explained subsequently that these amounts "could be paid

Commerce, December 1913.

without incurring financial risk provided that the liquidation was properly supervised" and that under the government guarantee, "Imperial Bank would make no profit by this business but was assured against loss." It may be presumed from this that even before its suspension the Alliance Bank of Simla enjoyed an intimate and close contact with the Government which claimed a close converse with its affairs such as a central bank might have well envied. Could banks with purely Indian management have aspired to the same facilities and access to those in authority ?

The grounds on which the intervention was undertaken deserve careful examination. Under the Imperial Bank Act of 1921, instructions from the Governor-General to the Imperial Bank were specifically limited to safeguarding of Government balances or the financial policy of Government. The defence by the Finance Member of government action interpreted these phrases in the statute in this manner. He expressed himself as "most anxious that favourable conditions in the money market both in London and in India for borrowing sums needed by government in both markets on better terms . . . and the good effect which the balancing of the budget had created should not be upset." He seems to have felt, however, that this was too large a proposition to hang on the out-standing current and fixed deposits of the bank amounting to Rs. 7 crores only and that the technical excuse of law was hardly adequate to carry moral conviction. He, therefore, widened his defence, and in widening it widened also the future responsibilities of the government. He represented the step as "most desirable in the interests of Indian Finance and Indian Banking" and also as well calculated "to restore public confidence" and "to prevent . . . causing inconvenience and probably danger to other sound institutions."*
If the government admitted in 1913 its obligation to render assistance after a crisis has broken out, the Finance Member completed the admission in 1923 by including prevention as a part of the responsibility.

* Commerce, July 28th 1923.

But there was scepticism in the hearts of those who listened to the defence of the Government. Those among them who did not suffer from short memories found the promptitude of the Government on this occasion very strange with their slovenliness and reluctance in the 1913-14 crisis. How did the Government detect so quickly that the assets of the bank were of sound quality? They reflected that the Bank's clientele was largely official and European and, perhaps, in India such connections were a special advantage to which Indian enterprize may not aspire. Nor did they forget that undisguised hostility to and continuous vilification of Indian banks on the part of European banks and Journals was no mean factor in the 1913-14 situation. The Legislative Assembly conveyed its appraisal of the situation by a successful vote of censure against the Government.

The situation had changed in several fundamental respects when the Travancore National and Quilon Bank* suspended activities in the middle of 1938. Till 1935, the Government of India with its direct control of currency and its indirect control of credit through the Imperial Bank of India was the one unique authority to deal with emergencies of this kind. In 1935 was created the Reserve Bank of India with statutory duties and responsibilities for the banking stability of the country. The events of 1938 revealed the emergence of still another authority, provincial governments inclined to make provincial autonomy coterminous only with the aggregate welfare of their subjects. A bald statement of the course of events connected with the suspension of the Travancore National and Quilon Bank should make clear the confusion of guardianships, which, however, inevitable, has yet to be resolved in the only manner in which it can be resolved, namely, the permeation of one common mind in all agencies, *i.e.*, the Indian mind.

The Madras Government initiated consultations with the authorities of the Reserve Bank of India and made suggestions to the Travancore National and Quilon Bank to

* See pp. 318-20.

apply "to the Reserve Bank of India, to undertake an immediate and thorough investigation, through competent officers and accountants appointed by them, into the affairs of the bank and agree to act according to such advice as may be tendered as a result of such investigation for the continuation, re-organization or liquidation of the bank, whichever course is finally suggested."

In an appeal to the public to remain calm and refuse to be rushed by ill-founded rumours, the Prime Minister informed them that "the Government of Madras are taking steps to secure an immediate examination of the accounts and affairs of the banks in Madras." About two months later, he felt constrained to issue "on behalf of the Government of Madras" a statement "emphasising the fact that the scheduled banks in Madras are in a perfectly sound position." The statement proceeded "Even those banks that took help from the Reserve Bank during the recent crisis have cleared off all those accounts. Further, the local Reserve Bank has sanction to give accommodation to these banks, should such accommodation be ever found necessary." In another significant part of the statement, the Prime Minister informed the public that "I am in close touch with the Manager of the local Reserve Bank branch, and issue this statement as a result of the conversations I had with him."

The establishment of co-operation between provincial governments and Reserve Bank authorities is a significant precedent. It is a proof that even with all its technical apparatus and its great resources, moral weight and authority such as the Government of Madras supplied on this occasion are no mean factor in the successful fulfilment of the mission of the Reserve Bank. It is difficult to foresee when and in what manner the Reserve Bank will win the requisite confidence of the banks and especially the large public. In the meanwhile, it is a grave question to consider whether expression of opinions which carries with it no specific responsibilities, in case the opinion is unfortunately disproved by events, is a proper means to meet

critical situations. While "widespread and insistent demand from all over the province that the Madras Government should do something to reduce the distress caused by the suspension of business" is a natural incidence of the growth of democracy and immaturity of the Reserve Bank and "congratulatory telegrams and letters from all parts of the province expressing great satisfaction with the steps taken to restore the general confidence in the banks of the province and especially with the steps taken in regard to investigation and possible re-construction of the Travancore National and Quilon Bank" are a signal admission of the part which moral prestige played in the termination of the crisis, the spokesmanship which the Government assumed on this occasion in the place of the Reserve Bank may well prove more than a passing development in the future.

It is well to emphasize that it is not a question of mere initiative and spokesmanship which we have posed above. At some stage, in a crisis like this, questions of judgment as well are bound to be involved. In an early stage of the crisis, the Prime Minister used these significant words. "Whatever the statutory limitations of the Reserve Bank may be, the Government of Madras will exert their utmost influence to induce the Reserve Bank to use all its resources towards re-construction." In other words, the Government felt themselves sufficiently seized of the situation to indicate the lines along which the crisis should be met. Indeed, the Government seem to have even overlooked the existence of another authority which has to be reckoned with in such situations, the ordinary law and law-courts of the land. When the Courts were actually seized of the matter, the Reserve Bank could initiate nothing without their consent and co-operation. The Madras High Court, however, neatly disposed of the status of the conversations which had ensued between the Reserve Bank and the Government in these words. "I am afraid," said the judge, "I do not concur . . . in calling the result of the conversations which have taken place and which are evidenced

by the communique of the Government and the letters, an agreement."

While these events were taking place, the Central Government practiced a most unaccountable self-effacement. More significantly still, the Government of the State in which the bank was domiciled showed no desire or movement to save the bank.

(b) Banking laws contribute to public confidence in two ways. In the first place, they strive to insure, if not sound management, at least immunity from more flagrant abuse of place and power. Secondly, they aim at mitigating harm and distress when banks find themselves in difficulties or have actually to be liquidated. The objective of sound management so far as legislation can secure it will be discussed in the appropriate section.[3] Here, we shall be concerned with the second objective—the post-mortem protection laws may offer to and the confidence they may consequently inspire in, banks' creditors.

Protection to creditors of a bank could take several forms, ranging from complete to partial immunity from risks. The appropriateness of any form must be judged, not from the standpoint of private interests at stake, but in the main on the basis of its compatibility with banking conditions in the country and its conduciveness to future banking progress. Creditors of an individual bank are offered protection not because of any special claims they can urge as compared with investors in other enterprises. Such protection is only justified by the fact that the failure of one bank is apt to set in motion forces which endanger the whole banking system of a country. The failure of a non-banking enterprise rarely depreciates, much less destroys so completely the solid assets of other cognate enterprises.[4]

The most obvious form of protection would be a scheme to guarantee the deposits of banks. The liabilities under such a scheme could be kept within manageable limits by several precautions. In the first place, it is clear that the scheduled banks do not stand in as urgent a need of such a scheme as

those others which are not scheduled and which for a long time must remain outside the direct influence of the Reserve Bank. The fact of scheduling is itself some evidence of their respectability and fair management. On the other hand, the main danger to the structure of Indian banking is likely to ensue from those banks which are individually small but which in the aggregate constitute an important banking problem for this country. The compulsory inclusion of these banks in such a scheme will go a long way towards introducing some central control and regulation for these banks, and at the same time, limit the liabilities of the scheme. In the second place, there can be introduced a progressive limitation of the guarantee for deposits of larger size. Such limitation of guarantee is justified by the obvious fact that well-to-do persons are much better informed about the relative merits of different banks and that our future progress in banking depends very largely on the confidence our banking system is able to inspire in the small man. So limited, it should be easy to build up a sufficient insurance fund by compulsory contributions from the included banks on some equitable basis. A certain small percentage of the working resources suggests itself as a device free from odious possibilities.

The most cogent argument against any scheme of insurance is that the stronger and better managed banks do not feel the need of it and tend to look on the contribution as an unnecessary tax while the weaker and less responsible banks find it an encouragement to their incompetent and reckless methods and policies. Recent experience in other countries has, however, proved that countries with highly concentrated banking systems are no less vulnerable to panics than those with diffused banking structures. Apart from that fact, our proposal for insurance of deposits covers as an initial measure only those small banks which are not deemed at present as worthy of the status of scheduled banks. In the course of time, on account of the operation of the banking sections of our amended company law, these banks will consist entirely of those which have capital and reverses between 1 to 5 lakhs.

Another form of protection would be to give, in case of insolvency, statutory priority of repayment to a special class or classes of banks' creditors. As in the former case, it is possible to delimit on a progressive scale the benefit of priority to smaller deposits. Such priority may be thought of for instance in favour of fixed deposits and savings deposits. It is true that the loss of the privilege to protect themselves by quick withdrawals in case of danger is supposed to be counterbalanced if not fully indemnified by the higher rates which are offered on such deposits. It is also true that as a measure for restoring public confidence it is the practice of sound and respectable banks not to insist on their undoubted legal rights but to allow withdrawals to the fullest extent. But our proposal concerns only the smaller banks and the depositors of such banks are apt to be persons who require such additional safeguards. Such insurance of deposits may result in the additional benefit that these banks need not then indulge in highly deleterious competition to attract deposits by the offer of imprudent rates. They may sustain some loss on account of falling-off of current deposits but as things are at present, their dependence on these deposits is limited.

Another form of protection would be to throw the responsibility for it on each individual bank by stipulating the building-up of a reserve fund at a certain pace and up to a certain prescribed maximum. The special banking section of the Indian Company Law of 1936 has incorporated this form of protection. Before declaring a dividend a banking company is required to transfer a sum out of the profits equal to not less than 20 per cent. of such profits to its reserve fund till the amount of the fund is equal to the paid-up capital of the company. This reserve fund has to be invested in Government or trust securities or kept as a deposit with any scheduled bank. This protection is illusory in the case of many small banks which have a record only of continuous losses, particularly in Bengal where, as we have seen, they tend to be very numerous. In the case of other non-scheduled banks, it may be an advantage to relate the maximum reserve prescribed not to the capital but the

average of their deposit-liabilities for the three preceding years. Such a stipulation has the obvious justification that the reserve fund is largely intended for the protection of the depositors of the bank and may ensue in a further advantage that the tendency to inflate deposit liabilities out of proportion to the size of the bank will receive an automatic check. The irksomeness of the burden could be made more acceptable if in the case of new banks, the proportion to be abstracted out of profits were prescribed low in the initial years and increased progressively to full 20 per cent. in the 10th or 20th year.

It would of course be possible to combine these several forms of protection in such a manner as to throw more or less burden on the individual bank, a special class or classes of creditors and depositors, or on particular groups of banks. A distribution of burdens in this manner is likely to make such schemes more acceptable to the banking community.

(c) The Press and Public Opinion—The presence of a responsible and discriminating public opinion is one of the most effective safeguards of sound banking. The responsibility of the Press in particular in matters like these which are highly technical to appraise and yet which depend in such a large measure on the opinion and behaviour of the ordinary individual is very grave. In normal times, the Press should be able to exercise a constructive influence by giving well-deserved prominence to whatever is best in the banking system of the country and reproving, more by contrast than by words, whatever falls short of desired standards. In times of crisis and disturbance, the nation has a right to look to the press for discriminating self-restraint and leadership. The value of these qualities has been forcibly illustrated by recent contrasting events in the United States and the United Kingdom. It would be difficult to underestimate the part which incessant patriotic propaganda bore in creating a calm confidence in the British depositor in the crisis of September 1931. As a climax to the bewilderment caused by a series of political blunders and discreditable manouvering for party advantage, the

politicians and the press successfully hustled the ignorant Britisher into an emotion that the gold standard and the British banking system were of the same sacred order as the British Navy, Royalty and Empire.* In the banking crisis which followed on the heels of England's abandonment of the gold standard, the heterogeneous and less reverent press of the United States gave a different account of itself. Successive bank-failures were too good sensational news not to be exploited to increase the circulation. When there were no actual failures to report, dark hints foreshadowing failures proved no less serviceable. Only censorship could arrest the progress of this reckless, irresponsible and anti-social activity.

The creation of a well-informed, accurate and weighty public opinion on financial and economic matters is one of the most urgent needs of this country. The ultimate basis of sound economic and financial policies must be a public opinion of this kind rather than laws and constitutions. Some progress has been made with the growth of a few financial journals of general economic interest and a few other organs representative of special interests like the Indian Textile Journal, the Journal of the Indian Institute of Bankers, etc. For the rest, ill-staffed newspapers, individual businessmen, economists and chambers of commerce etc., are in possession of this field.

We have already had occasion to notice the power and danger of the written or spoken word, well-founded or not.† Never were this power and this danger better illustrated than in the banking crisis of 1913-14. That crisis was preceded and in no small measures caused by the prolonged, Anglo-Indian newspaper broadsides to which Indian joint stock banks were exposed for two or three years previously. The lead in this hot onset was taken by "Bayard" in the columns of the Commerce which published week after week articles from that vitriolic pen, each more spiteful and poisonous than the previous. It is true that many of the enterprizes criticised by Bayard hardly deserved

* The Mechanism of Exchange, by J. A. Todd (Oxford University; 3rd Ed.) pp. 190-93

† See pp. 186-87; 191-92; 201; 213; 218.

to be called "banks." But as one peruses criticism piled on criticism by that writer, one cannot but recognise the deliberate venom spouted at all 'Swadeshi' banks as a class.

Lala Hari Kishen Lal was undoubtedly the central object of the hottest fire of Bayard. His contemptuous notices of the "Napoleon of Punjab Finance" were reinforced by the *Arya Patrika* of Lahore which obliged the public with the information that the directors and auditors of the Peoples Bank were under obligations to Hari Kishen Lal. When the Peoples Bank fell, Lala Hari Kishen Lal ascribed the catastrophe with some shadow of justification to the agitation of his enemies in the press.* Other victims of the incessant ridicule and attacks of Bayard were sometimes moved to protest and contradict.† For the vindication of his personal reputation, Lala Hari Kishen Lal himself had to wait till the publication of the official report of the liquidators.

The failure of the Travancore National and Quilon Bank created in 1938 an equally serious situation in the Madras Presidency. The Prime Minister of Madras described the situation in these words. "Consequent on the suspension of payment by the Travancore National and Quilon Bank, the confidence in the banking system has been shaken among the people of the city. Everybody is inclined, as a result, to cash his deposits in whatever bank they may be." Two months later, despite the efforts of his government to restore confidence, he was constrained to issue a more direct statement on the subject. "The reported activities of some mischievous persons render it necessary to issue this statement emphasizing the fact that the scheduled banks in Madras are in a perfectly sound position."

While the existence of the evil itself cannot admit of any doubt, it is not easy to suggest a remedy which will be effective and at the same not unduly restrictive of legiti-

* Commerce 19th and 24th September, 1913.

† Thus, the managing director of the Popular Bank of Rawalpindi—"As regards other matters, I may confidently tell you that either the writer is misinformed or he has a malice against the personality of the Managing Director. I may assure you that not an iota of what your correspondent has stated is based on facts."

Commerce, 17th September 1981.

mate criticism. But while a special law of libel for banks may not be feasible, it is within the range of the practical to make punishments specially deterrent in the case of banks. The same may be suggested for dealing with frivolous legal proceedings which are so frequent in this country.

(d) While our banks have a right to expect a proper responsibility in the expression of opinion from the press and individuals, and, should need arise, due protection from public authorities, they owe it to the country no less than to themselves that they should take every precaution to forestall the causes and moderate the effects of serious situations. There are three possible sources of embarrassment against which the banks will be wise in arming themselves.

Nothing is less likely to hinder the enduring interests of a bank than undue obscurity and concealment of its affairs. Confidence is no doubt slow to grow. But clear and informative balance sheets are certainly a good means to create it. In our analysis of balance sheets, we shall indicate several directions in which they could be improved. It is true that the public is as a rule ill-qualified to appreciate the merits of a balance sheet, that an isolated balance sheet is like an event in the biography of an individual which is understandable only in the light of the past, that the public rarely waits to compare and to study, particularly when distress and adversity are feared. But this only means that banks must endeavour to reach down to the level of public intelligence and that efforts must be sustained over long spells of time.

In this matter of confidence, there are at least three parties directly involved, the shareholders of each bank, its depositors and the whole community of depositors in general. Present practice recognises the claims for information and control only of the shareholders. Yet the confidence of the other two classes is in no less degree a vital condition of the future progress of banking in this country.

One recently established bank has already set an example by making room on the Board of Directors for a depositors' director. In the case of the bigger banks, it may not perhaps be feasible to give such representation to all depositors small and big. But if representation were given to those who maintain an average balance above a certain minimum and the list were revised every three years, the step should go a long way towards enhancement of public confidence. It would, however, be unjustifiable to exaggerate the virtue of such representation. It is the settled practice of shareholders to take no interest in their concerns when profits are good and to reserve their combativeness and bellicosity for times of stress and difficulty. There is no reason to presume that depositors as scattered through the several branches of a bank as shareholders will be better able to discharge their responsibilities. Their representation is more likely to be merely symbolic but even symbolism has its special advantages in these spheres of human life.

It is when we think of the confidence of the public and the banking community in the banking system as a whole that the problem presents itself in its proper perspective. Public confidence can rest only on the impartial opinion of some public authority or, in ordinary times, on the belief of the public that their interests are being watched by some competent authority. There are only two authorities which we could conceive of in this connection—the government of the country and the Reserve Bank of India. The intervention of Government can be, as we have already observed, only an emergency and last stage resort. In all other circumstances and stages, the power and leadership belong naturally to the central bank of the country. Unfortunately, the recent worldwide crisis has revealed that central banks as constituted at present are incapable of helping themselves or individual banks. The crisis proved that the more recently created banks have yet to acquire the authority and public confidence which are the outcome of slow historical evolution; secondly, that their legal powers while suited for ordinary times, could not be quickly adapted for any bold or heterodox innova-

tions; thirdly, that their executive is not qualified to assume the full weight of national interests. The creation of the Reconstruction Finance Corporation and the Federal Deposit Insurance Corporations in the United States, the creation of special authorities like the Reich Commissioner for Credit in Germany, Inspector of Banks in Italy, etc., testify to the loss of initiative by central banks and their subordination to Government as an experienced and valuable advisor. In the creation and management of Exchange Equalisation Funds, the Governments have actually undertaken banking functions in which again the role of central banks is largely advisory and consultative. These developments should warn us against looking to *a priori* principles of central banking and laws based on them rather than on expert knowledge and devotion to national interests in the executive of the Reserve Bank for the future progress of our banking system. The powers of the Bank may have to be extended in such wise that it has full means to avert more extreme developments and when they cannot be averted, to meet them in an effective manner. Ex-officio representation of the Reserve Bank as observer on the Boards of Management of the scheduled banks, powers to obtain compulsory returns and institute examinations of affairs, the concentration of all banking-audit and even other audit in a special department of the Bank —these are some directions in which the present organisation and powers of the Reserve Bank could well be expanded.

If the public in this country has yet to learn to look on our banks as national institutions, the banks on their part owe it to the country no less than to themselves that they should avoid all communal or sectarian affiliations. Bitter experience has proved again and again that in the course of these conflicts no institution escapes their ravages. The contending parties carry their war sooner or later into every institution which is or is believed to be a stronghold of the opposing parties. By their very nature, the clientele of banks, whether depositors or borrowers, is very cosmopolitan which makes their position delicate and

vulnerable. A run on a bank by any large section of its creditors must develop sooner or later into a general run in which other people who are in no way interested in the conflicts and indeed the sectarian supporters of the banks even participate. Sinister warnings on this point are not lacking in the history of certain institutions and even banking furnishes certain examples. A close connection between British political power and British commercial enterprize is a postulate of Indian attitude on many economic questions and in banking, the opinion held about the past policies of the Imperial Bank or about the real motive behind the prompt assistance given to the Alliance Bank of Simla illustrates the point. Several other examples of the same kind have been already met with in our account of the history of Indian banks or the history of bank failures.

Low Level of Incomes

No other single cause is more responsible for the slow growth of the banking habit than the general poverty of the people. Figures relating to the number of assessees to Income-tax and the average size of the incomes, the number of depositors in postal savings banks and the average deposit per head, etc., testify amply to the narrow basis on which the banking habit has to be reared. The extension of branches, it has been already recorded, has caused a progressive decline in the average volume of resources available per branch. In other words, every advance in the creation of banking facilities must in future be secured in spite of a progressive decline in the income-level of depositors. It is indeed a common experience even now that many people, high in educational or social status have to forego the pride or convenience of a bank-account because of sheer inability to maintain a decent balance at the bank.

The banks on their part cannot claim that they have reached a proper balance between income-levels in this country and their conditions for opening accounts or giving

charge-free use of banking services. In prescribing a minimum initial deposit, banks aim at assuring at certain financial status in their depositors. In stipulating the maintenance of a certain minimum average balance, they aim at securing payment for the costs of banking business and some margin of profit. It seems that these conditions tend to be onerous for most incomes in this country. Many important banks require as high an initial deposit as Rs. 300 to 500. Some banks which require an initial deposit of Rs. 300 or more expect a credit balance of no more than Rs. 100 to be maintained in the course of the relationship. These figures appear unduly high when compared with certain stray evidence of the average size of accounts in this country. It is likely that even for the bigger banks the average volume of balance per current account is no more than Rs. 1,000 at the most. From the experience of other countries, particularly the United States, it may be presumed that the bulk of current deposits of a bank is made up by a few big accounts while the greater number of current-accounts consists of small and even unprofitable accounts.

Statistics relating to postal savings bank deposits may be helpful in fixing the range of our estimates on this subject. The postal savings bank deposit per head moved in the neighbourhood of Rs. 120 till 1920 and with the growth of wealth in recent years, the figure has improved to Rs. 190 in the last few years. If these savings were estimated to cover a period of life of ten years on the average, it gives us annual contribution of about Rs. 20 in round figures. Even if these 42 lakhs and odd account holders were assumed to save only 5 per cent. of their incomes in this manner, this should mean an annual income or expenditure per family of about Rs. 400. It is probable that postal savings bank depositors are drawn from much poorer strata of society than those on which our banking system must rely for the supply of its resources. Nevertheless, these figures illustrate the narrow basis of banking in this country and the need of revising some of our

banking practices in harmony with our economic environment.*

Of course, banks as profit-earning concerns cannot approach the subject from the side of income-levels alone. They have perforce to take into account the profitability of each individual relationship. The direct profitability of an account must vary according to its average size from year to year, the number of cheques drawn on it on the average *i.e.*, its activity, and the cost of handling each cheque. It is clear that reliable estimates of these factors involve elaborate and painstaking accounting analysis. It has been estimated in the United States, for example, that the cost of handling a cheque works out on the average at 3 cents. It would be strange if in India this cost is above 1 anna per cheque. If an average balance of Rs. 100 in an account earns for a bank 2 per cent. per annum, it might mean loss to the bank if more than 32 cheques per annum or more than three cheques per month were allowed to be drawn on it free of charge. Of course, for a final estimate of the profitability of an account, other incidental advantages like loans borrowed by the customer, his safe custody business, his advertisement value, etc., have also to be taken into account. The fact that as high a percentage as 57 of the total accounts in the United States is reported to be unprofitable to the banks proves the extent to which banking facilities may be based on considerations other than direct profit. It may be per-

* Central Bank of India.

		Number of current Accounts.	Current and Fixed Deposits (lakhs)	Average Current and fixed deposit per current Account.
1914 December	...	1,560	30	Rs. 1,900
1915 June	...	1,700	48	,, 2,800
1915 December	...	2,000	50	,, 2,500

In 1912, more than 2/3rds of total deposit liabilities were accounted for by fixed deposits—the average volume per account of which is generally smaller than in the case of current accounts and the bulk is made up by many small accounts. By 1921, fixed and saving deposits fell to about half of total deposit liabilities.

Imperial Bank. Current Accounts.
(Branches in C. P. and Berar)

		Number	Total (000)	Average per Account.
December 1925	...	1,584	3,331	2,100
,, 1929	...	2,190	5,158	2,300

Of 30,000 and odd British creditors of the Travancore National and Quilon Bank, 20,000 and more were reported to be for Rs. 50 and under. Presumably, most of these accounts were fixed deposits. The aggregate liabilities, fixed and current, amounted to Rs. 242 lakhs. Assuming that the bulk of current deposits had been withdrawn by that date, this works out at Rs. 800 per account for fixed deposits.

haps feasible for Indian banks to frame schedules of the number of cheques they are prepared to allow free of charge for accounts of varying sizes and to make a service charge for any excess above the minimum number. The present insistence on a large initial deposit seems to be out of harmony with the economic conditions of a country in which gazetted officers of Government start with salaries of less than Rs. 200 and in a few cases with Rs. 300 to Rs. 400. The changes suggested above must be preceded by scientific inquiries and should, when effected, go a long way towards attracting smaller folk into the banking system.

Ignorance and Illiteracy

Illiteracy and absence of education in general cannot but be grave obstacles to the growth of economic habits and modes of business which pre-suppose ability to write and affix signature to cheques, follow the purport of rules, documents, etc. It is, however, possible to exaggerate the significance of these obstacles to the spread of the banking habit. The illiteracy and ignorance which are relevant to this problem are the illiteracy and ignorance of those only who reach the minimum income-level pre-supposed in a bank-account. Considered in this light, it is very doubtful whether the obstacle really operates in the case of more than an insignificant fraction of those who can afford to have a bank account. The assessees to the income-tax which covers all non-agricultural incomes did not exceed 700 thousand in the year 1935-36 when the minimum assessable was Rs. 1,000. The number of persons who live primarily on rent of agricultural land was returned by the last census at 32½ lakhs only.* If the Travancore National and Quilon Bank were taken to represent average banking conditions in 1937 and Rs. 1,000 were taken as the mean size of deposits for all depositors of the Indian Banking system, the aggregate number of depositors would not exceed 30 lakhs in that year. This number may be compared with the number of account-

* i.e. "workers" only.

holders in the postal savings banks which ran into about 35 lakhs in the most recent return. The number of literates themselves was returned in 1931 at 281 lakhs for both males and females. These figures and the general experience that illiteracy and poverty are as a rule inseparable twins indicate that these particular obstacles are much overstated. Nevertheless, since every effort must be made to build up the banking habit, the extension of the use of vernaculars for all banking purposes deserves to be attempted in all favourable circumstances.*

II
BANKING LAWS

The causes inspiring banking legislation vary according to the history and circumstances of each country. Much of the legislation in the United States, and, to a limited extent in England, was motivated by a desire to regulate and assure the redeemability of note-issues. With the assumption of the note-issue by the government in 1861, such a cause for banking legislation ceased to exist in India. The monetary and exchange difficulties of the post 1920 era induced many countries, new and old, to undertake banking legislation bearing chiefly on the powers and functions of central banks. It was not till the Great Depression and banking crisis of 1929-33 that the law was invoked almost everywhere and on a sweeping scale as a remedy for almost every conceivable banking ill.

The desire for banking legislation in India is to be traced to the one great banking crisis which this country faced in 1913-14. The objective aimed at has been the protection of the public against its own ignorance, protection against the ignorance or dishonesty of those who float or manage banks and finally the protection of Indian banking general against powerful foreign competition. The enactment of the Reserve Bank Act was due, as we have recorded, to the anxiety of British commercial and political interests to remove monetary and currency questions beyond the reach of Indian political influence.

* The minimum for assessment to income-tax from 1936-37 is Rs. 2,000 per annum and in that year the assesses were 373 thousand only.

Form of Legislation

The ends of banking legislation have been secured in different ways in different countries. Some countries have preferred to introduce special clauses bearing on banks in their general law relating to joint-stock enterprize. Others have promulgated special banking laws. A few have special laws which include in their purview not merely banks but other allied and cognate concerns as well.

Till 1936, India had no banking legislation of any kind. Banks like other concerns had to conform to the general requirements of Indian company laws. The Act of 1936 made the first and a very significant departure. Part X-A was devoted exclusively to banks and was meant to be merely a precursor of a special law on the whole subject.

The first effort at legislation on the subject of joint stock enterprise in general was the Joint Stock Companies Act of 1850. This Act made members of a company registered under the Act liable for the debts of the company in proportion to their holdings. The law conferred on companies legal personality, prescribed for them audited balance-sheets and profit and loss accounts and made provision for their winding-up. The Act of 1857 created limited liability for all companies except those for banking and insurance. The Act of 1860 removed the exceptions. These various enactments were later consolidated into one statute—the Companies Act of 1866. Although amendments were made now and then *e.g.* in 1892, a reconstruction of the statute was executed only in 1913. The law which governs this subject at present is the great enactment of 1936, the Indian Companies (Amendment) Act 1936.

Law Relating to Balance-Sheets of Banks*

In the present era of joint-stock enterprise, the legally enforced publication of balance sheets is no doubt the greatest safeguard against flagrant types of financial dishonesty or incompetence. From 1866 onwards, the laws relating to joint-stock enterprise have endeavoured to make this safeguard as strict and effective as possible. Unfortunately, from the standpoint of banks, these efforts have laboured under a grave drawback. The Indian Company Law has always adhered to one general form of balance-sheet to which all companies are expected to conform. Any special provisions for banks as such have been incidental

* A Specimen Balance-Sheet.

Liabilities:

Authorised, Issued and Subscribed Capital
- Paid-up Capital:—(1)
- Reserve Fund:—
- Reserve for Contingencies:— (2)

Deposits:—
- Fixed, Short and Savings Bank:—(3)
- Current and Contingency Accounts:—(4)
- Rebate on Bills Discounted and Treasury bills, notes due:—(5)

Profit and Loss Account:—
- (i) Balance from last year:—
- (ii) Profit from the current year:—
- (iii) Less income-tax, etc.:—

Contingent Liabilities:—(6)

Assets:

Cash Credits and Demand Advances:—(7)
Loans:—
Bills Discounted and Purchased:—

Particulars required by Act VII of 1918:—
- (i) Debts good and fully secured; (in which Director is concerned) (Total maximum balances in the year)
- (ii) Debts good and secured by liability of other persons. (bills discounted) (due from joint stock co., with agent's guarantee, a bank director being concerned)
- (iii) Debts good but secured by debtor's liability;
- (iv), (v), (vi), (vii) Debts doubtful, bad, to directors personally, due from other officers, etc.

Landed Property below cost:—
Investments at or below market rates:— Bullion, Government security, Improvement Trust and Municipal bonds, joint-stock company debentures and shares;

Government of India Treasury Bills:—
Cash in hand and at Bankers in Current Account:—

(1) It is rarely the practice of Indian banks to maintain a part as uncalled reserve liability to be called up in case of liquidation as in England.
(2) This is a reserve against those liabilities which may materialise after the preparation of the balance-sheet, e.g. re. bills discounted, guarantees; unfinished contracts; pending actions.
(3) The usual period for fixed deposits is 1 year! 'Short deposits' are a feature of financial centres like Bombay and Calcutta.
(4) Contingency Accounts:—These are hidden reserves, provision for bad and doubtful debts, depreciation of investments, and many other unknown items.
(5) Rebate is allowance made for discount received but not earned since the maturity of the bills concerned extends beyond the date of closing the balance sheet.
(6) These are liabilities which are contingent on the happening of events which may or may not happen e.g., as regards bills discounted; guarantees, unfinished contracts, actions in court etc.
(7) A cash credit is fixed as a maximum against promissory notes, two sureties, hypothecation of stocks. Interest is charged only on the amount actually used but interest on a minimum balance has to be paid. The facility is terminable at any time. Demand advances are also repayable at any time but as a rule notice is given.

rather than conceived on a comprehensive and well-laid plan. This has meant a good deal of undesirable latitude and a good deal of unnecessary obscurity. The construction of a special form of balance-sheet for banks is one of the most urgently needed reforms.

The Indian Companies Act 1866 required banks and other cognate concerns on a limited basis to publish, in a summary form, statements of their assets and liabilities twice a year. Except for inconsequential alterations of dates, the form of 1866 has been rigidly adhered to in all subsequent acts and amendments.* As avowed summaries, they have significance only in the light of the balance-sheets of which they are the forerunners or successors.

The Act of 1866 required that a balance-sheet of the property and liabilities of the company should be made out† once at least in every year. The Act of 1913 amplified the object of the summary which must give particulars so as to disclose the general nature of the liabilities and assets and how the value of the fixed assets has been arrived at.‡

The Act of 1936 made no alterations in the above stated particulars. But it made one important addition. When a company holds shares of a subsidiary company, the balance-sheet of the holding company must contain as an annexture the last audited balance-sheet, profit and loss account and auditor's report of the subsidiary company or companies as well.

In the case of institutions like banks whose business is much influenced by the course of the seasons, the time of publication of the balance-sheets is obviously a very important matter. Unfortunately, there is no uniformity of practice on this point yet. Most Indian joint stock banks publish their balance-sheets as at the end of June and December. But there are some exceptions. The Union Bank of India and after its affiliation to the P. & O. Banking

* Act of 1866—as on 1st day of January or July, to be published on 1st Monday in February and 1st Monday in August.
Act 1913—as on 31st day of December or 30th of June—to be published on 1st Monday in February and 1st Monday in August.
Act 1936—same as 1913-A.

† Act 1866. S. 49.

‡ Galloway v. Schill and Co., 1912, 2KB 854 and 1927, 29 Bom. L. R. 722.

Corporation, the Allahabad Bank of India prefer to state their accounts as on 31st day of March. Apart from the difficulties of compiling a general statement for Indian banks as such, there is also the danger that such divergences of practice may encourage window dressing by means of temporary transfers of cash deposits to needy banks.

There is also a good deal of varying practice about the publication of profit and loss accounts. Many Indian banks *e.g.*, Bank of India, Allahabad Bank, Bank of Baroda, Bank of Mysore, the Central Bank of India, etc., publish along with their December balance-sheets yearly accounts of profit and loss. But the Indian Bank and the Punjab National Bank publish only half-yearly accounts at a time. The Imperial Bank adhered to the latter practice till 1933. From that year, it began to publish its aggregate yearly profits but they are stated unlike other banks as from June to June.

The Table A to the Act of 1866 prescribed the form of balance-sheet which companies were required to conform to as near as circumstances admitted. It is noteworthy that while in England the form was omitted in the subsequent Act of 1908, our Act of 1913 continued to adhere to the form with certain amplifications. These amplifications deserve to be noted as bringing out the limitations of the law as it existed before 1913.

Capital.—The Indian Company Act 1866 required a statement of the number of shares and the amount paid per share. The 1913 Act changed this to a statement per share and in the aggregate, of the authorised, issued, subscribed and paid-up capital under each separate head. The change was useful not merely as enabling an easier understanding of the owned resources of the company and resources which could be evoked at a short notice but served also as a constant reminder of the proportions which the three magnitudes bore to each other and therefore as a check on irresponsible or fraudulent devices meant to impress public ignorance with mere paper figures.

The amendment of 1936 distinguishes between various classes of capital. Shares issued as fully-paid-up but without receiving any cash for them have to be stated separately from those for which cash payments are to be realised. Under the head "calls unpaid" the amount due from the managing agents has to be separated from dues to be realised from others.

Reserve Funds.—The Indian Company Act 1866 had only one head—Reserve Fund. It was explained as showing the amount set aside from profits to meet contingencies. The 1913 successor adds several other funds to what it then described as "Reserve Fund or Development Funds." These new funds were—any sinking fund, any other fund created out of net profits.

This head again has revealed a good deal of divergent practice in balance-sheets. The Punjab National Bank, for example, states separately Funds for Contingencies and Funds against Depreciation of investments. The Indian Bank follows the same practice. Other banks find need for other ingenuities.

Debts and Liabilities.—The Indian Company Act 1866 had an omnibus head "Debts and Liabilities" to show firstly, amounts of loans or debenture bonds and secondly, amount of debts owing by the company distinguished under several specific and one miscellaneous sub-head. The fixed and other deposits of banks fell naturally under the last miscellaneous sub-head which called for no details.

The amendment of 1913 split the second part of the omnibus "Debts and Liabilities" mentioned above into several independent heads with slight changes of description. The most significant change was the creation of two new independent heads namely loans otherwise secured (stating the nature of security) and loans unsecured which now took the place of the last miscellaneous sub-head mentioned above. The head "unsecured loans" now covered the deposits of banks. Again no specific details were prescribed by the Act.

The 1936 Act specifies several details under the head Loans (a) secured and (b) unsecured. Under the latter head occur the important items—loans from banks, fixed deposits, short-term loans, liabilities to subsidiary companies, etc.

The balance-sheets of Indian Banks do not observe any uniform practice regarding deposits. The Imperial Bank of India and among the smaller banks, the Indian Bank and the Union Bank of India do not separate fixed and current deposits. Those banks which separate them act presumably on no uniform definition of fixed deposits or "short" deposits.

Again, banks which state currents and fixed deposits separately are not agreed on the status of saving deposits. The Allahabad Bank and Bank of Mysore have adopted the sensible course of stating their savings deposits under an independent head. In view of the rapid growth of these deposits in recent years, this practice is to be much commended. Alone among important banks, the Bank of India follows the less objectionable course of putting savings deposits together with fixed deposits. The Central Bank and the Bank of Baroda lump them with current accounts. The undesirability of such varying practices is thrown into bold relief by the behaviour of the Punjab National Bank on this point. Till 1936, savings accounts were combined with current accounts. For unexplained reasons, they were thereafter placed with fixed deposits.

So long as savings deposits formed but an insignificant part of a bank's borrowed resources, this variety of practice could not cause much misinterpretation of the situation of any bank. But as the figures relating to the Allahabad Bank and Mysore Bank suggest, their importance has grown strikingly in recent years.* Indeed, this development is not exceptional to India but has been observed in many other countries like the United States, etc. It must conduce to greater clarity and more accurate interpretation if all banks followed the practice of these two banks. In the

* Pp. 13-15; 206; 217; Tables XXI, XXII, XXV, XXVI

Q 7938-88 Minutes of Evidence, Hilton-Young Commission.

alternative, a uniform procedure of combining them with fixed deposits is to be preferred as being more logical.

The changes in the other heads of the 1866 Act, namely, Profit and Loss, Contingent Liabilities and creation of a new head Advanced Payments and Unexpired Discount do not need any special comment.

Property held by Company.—We may now turn to the assets side. The first head under the Act of 1866 is "property held by company," which is distinguished as immovable property and movable property. The cost was to be stated within deductions for deterioration in value as charged to the reserve fund or profit and loss. The 1913 Act drops the distinction between movable and immovable property, combining the two as "Fixed capital expenditure." The Act of 1936 added a significant clause that once sums have been written off on a reduction of capital or revaluation of assets, subsequent balance-sheets must show the reduced figures.

Book-Debts.—A very important head in the Act of 1866 was "debts owing to the company" corresponding to the head "book-debts" in the Act of 1913.

The Act of 1866 distinguished first "debts considered good for which the company hold bills or other securities." In the Bank of Burma case, Mr. Justice Twomey explained the wide significance of the clause as it stood in the Act. The sole pro-note of the debtor was enough to make the debt one with security to support it. It did not matter if the security, when there was any, was grossly inadequate—the Act did not require full security to justify inclusion under this head. No line was drawn between good and bad security and even when the security depreciated, the debt may be still classed under this head as a secured debt. True, reputable accountants developed a practice of classing under this head only those debts or those portions of debts which were fully secured. But the Act itself did not lead to such a construction.

The Indian Company Act of 1913 terminated this vagueness. In the case of a bank, it distinguished those debts for

which it is fully secured from those which are good but for which the bank holds no security other than the debtors' personal security.

The next head under the Act of 1866 was debts considered good for which the company had no security. The Act of 1913 continues this head of "good debts." The definition of a good debt is obviously a difficult point. In the case cited above, the judge described it as a business term to be interpreted in the light of relevant business standards and declined to lay down any definition of his own.

The third sub-head under the Act of 1866 was "debts considered bad and doubtful."

This head was a natural embarrassment to banks. Acknowledgment of debts of this kind was inevitably looked on as an invitation to suspicion and loss of confidence. Bankers and auditors all over the country developed practices according to which these debts were placed in the class 'good debts' on condition that a secret reserve or contingent fund was created on the liabilities side to the full amount of the debts. As was emphasised in the Bank of Burma case cited above, absence of a reserve meant that the debt must be specifically shown under the bad and doubtful category either to the full extent or to the extent of the difference between the amount of the debt and the amount of the provision against it.

Although no dishonesty could be imputed to such a practice, it was certainly not a strict and correct compliance with the law. The Act of 1913 retained this sub-head in its original form F, adding the significant words "in all cases," *i.e.* in the case of all companies including a bank. In the Central Bank of India case (1927), the question of interpretation was disposed of in the only valid manner possible. "Book-debts" can only mean debts owing to the company and so shown in the books of the company. Unless a debt was actually written off, it should have its proper place on the assets side. The fact that chances of recovery were non-existent or that a reserve was held in hand against it could not make it less of a debt.

The Act of 1913 had added in this connection one more obligation on the liabilities side which found no place in the Act of 1866. There occurred the head "Provision for Bad and Doubtful Debts" which again made it necessary that when the reserve was invoked to meet such debts, the amount should be revealed under this head and not hidden from the public eye.

After the decision in the Central Bank case, a notification of 1927 gave legal status to the practice of bankers and auditors described above. Banks were now relieved of the embarrassment of the sub-head, "Provision for Bad and Doubtful Debts," on the liability side altogether and on the assets side they were not required to state their bad and doubtful debts when provision was made against them to the satisfaction of the auditors. It is clear that the amendment throws an unambiguous duty on the auditors to assure themselves that all bad and doubtful debts which do not appear in the balance-sheet are reserved against.

The Act of 1936 cancelled the notification of 1927. Doubtful and bad debts were to be so shown and "Provision for Bad and Doubtful Debts" reappeared once more on the assets side. But this change appears to have been due to mere inadvertance. Early in 1937, the Governor-General-in-Council directed that alterations be made in Form F in the III Schedule of the Company Act restoring the notification of 1927. In the Column headed "Capital and Liabilities," banks were relieved of the necessity of showing "Provision for Bad and Doubtful Debts" and in the Column "Property and Assets" the sub-head "Book Debts" was qualified with the addition of the words and brackets "(Other than Bad and Doubtful Debts of a Bank for which Provision has been made to the Satisfaction of the Auditors.")

The last sub-head is "Debts due by Directors and other Officers etc." The Act of 1866 had a head which ran "Any debt due from a director or other officer of the company to be separately stated." In order to include debts held by

these parties conjointly with others, the 1913 Act adopted the more comprehensive description. Under the old sub-head, each individual name and amount were required to be disclosed. But it is not clear whether the new Act presumes a continuation of the old practice or requires only the total amounts of such debts.

Cash and Investments.—With regard to investments, the 1866 Act required a statement merely of their nature and rate of interest. The 1913 Act separated the two heads "Cash" and "Investments" and with regard to the latter required that the mode of valuation *e.g.*, whether at cost or market value should be stated. The Interest on Investments was placed under a separate head of its own.

The 1936 Act requires details under the head Investments. Government or trust securities, investments in shares, debentures and bonds, investments in scrips of subsidiary companies, investments in immovable properties have to be separately distinguished.

The treatment of "Cash" varies in actual practice from bank to bank. Some banks *e.g.* the Allahabad Bank include call-money under Cash. The Central Bank and the Bank of Baroda state call-money separately. The Punjab National Bank includes under Cash drafts in hand as well. It is obvious that the last named practice tends to inflate unnecessarily both the cash and deposits of the aggregate banking system. With less scrupulous banks, the practice may lead to more dangerous consequence. In the case of the Travancore National and Quilon Bank, it was found that "entries in bank accounts were manipulated at the end of the financial year by drawing bogus cheques and then reversing them at the beginning of the next year evidently with the object of concealing the real financial condition of the bank and to make it appear in the balance-sheet that the Bank was earning a profit."

Advances: Bills of Exchange.—The 1913 Act created these two new heads which had no place under the former Act.

Under Advances, the 1936 Act distinguishes loans given to subsidiary companies and loans to directors and managers.

Most Indian joint stock banks state separately Cash Credits, Demand Advances and Overdrafts on the one hand and loans on the other. But the Punjab National Bank and the Indian Bank put these items under one omnibus head. The Union Bank which followed the former practice till 1936 began to lump the items together thereafter.

Interest Accrued on Investment.—The inclusion of a sum which was never paid and was never likely to be paid amounts to a false statement involving criminal liability. It has been held however that a bank is entitled as a matter of course "to reckon as profit the unpaid interest on any debt which is honestly considered to be a good debt."* In another case of this kind it was laid down that to justify payment out of profits of this kind, the directors should have satisfied themselves that the debtor "is a man whose liability is as good as cash."

Profit and Loss Account.—Banks in India differ very much in the amount of information they give in their Profit and Loss Accounts. The Bank of India, Bank of Baroda, Bank of Mysore, Union Bank and the Imperial Bank of India give only their gross profits *i.e.*, the difference between their aggregate earnings and interest paid by them to depositors, etc. The Allahabad Bank, Indian Bank, the Punjab National Bank, etc., state both the aggregate earnings and the interest paid. All banks give of course their expenses and their net profits. The items of expenditure are not however arranged on the same plan—although fortunately the important item "salaries" is invariably stated separately. Alone among the leading banks, the Central Bank of India gives, in addition to all this information, the interest paid on fixed and current deposits separately. For the earlier years, it used to supply the aggregate number of its account-holders. It is clear that a standardization of this information will be a great aid to the understanding of the economy, efficiency and general tendencies both of individual banks and the banking system as a whole.

* 1930, 134 Ind. Cas. 909 (Sind) re. Karachi Bank.

Law relating to Officers of Banks

The law holds directors and officers of a company criminally liable for false statements under three conditions. In the first place, the statement must be false in some material particular. Secondly, the statement should have occurred in one of the documents like balance-sheet, prospectus, etc., required for the purposes of the Indian Company Law. Finally, the statement should have been made wilfully, knowing it to be false.*

The falsity of a document may lie in its general tenour, although no specific statement in it is false. When mere technical point or points regarding correct or incorrect accounting are involved, no wilful dishonesty can be imputed to the statements.

The civil liability of officers of a company is fixed by Section 235 of Act 1866, Act 1913 and Act 1936. Officers of a company are made answerable for misfeasance or breach of trust which includes breach of duty whether as an act of commission or ommission. The misfeasance need not be a fraud *i.e.* involve moral censure. To fall under this section, the misfeasance or breach of duty must result in pecuniary loss and the applicant must have a direct pecuniary interest in the success of the application. For purposes of this section, an auditor appointed by a general meeting of the shareholders is an officer in the company.

Innocent mistakes or mistakes of judgment even though they may be so gross as to appear absurd and ridiculous involve no liability. To make officers liable, the imprudence must amount to gross negligence *i.e.* absence of care such as a reasonable man might take and not absence of all possible care. Non-attendance at board meetings would not necessarily be negligence. By section 86 F of 1936 Act, absence, deliberate and without the leave of directors from three consecutive meetings or for a period of 3 months, whichever is longer, is reckoned among causes requiring the vacating of director's office. The directors are justified in

* 1918, 22 I. C. 482 (L. Bur.) re. Bank of Burma case.

trusting the accredited officers of the company but not to the exclusion of the exercise of their own judgment.

A few decided cases should illustrate the kind of causes which might raise the issue of liability with special reference to banking. In the Union Bank case,* it was held that "acting blindfold" putting "blind faith" in the ability of a manager, "submitting their judgment to the disposal of a manager" made directors liable. Further, a distinction was drawn between banking and other business. In other business, to keep a watch and check on a fluctuating stock of goods like yarn was impracticable. But the directors of a bank could and should see that bank funds are not offered to worthless debtors. In the Sholapur Bank case,* the directors who exercised no supervision or control over the managing agents were held recklessly careless and grossly negligent. The 1913 Act permitted articles which could indemnify directors against any loss or damage except that caused by their dishonesty. But, in this case, such articles though enacted did not avail them. An overdraft to a customer does not ordinarily make directors liable for loss. But if a part of the overdraft is received by the directors as creditors of the customers, they must refund it. Directors, it has been suggested, must inform themselves of the purpose before they sign cheques. To continue to carry on business and incur debts when there is no reasonable prospect of the creditor ever receiving repayment has been suggested as proof of an intent to defraud. The application of such principle means in regard to receipt of deposits, etc., obvious difficulties for officers of banks which are on the decline but not quite despaired of.

The 1913 Act had also enacted that the Indian Limitation Act applied to applications made under this section. In actual practice, the widest divergence of opinion prevailed as to the date from which the limitation began to run. The date of liquidation, date of misfeasance or, as in the case of Bombay, date of the first ascertainment of the loss by the company were taken as the point from which the limitation began to run and the period was variously two years, three

* 1925, 47 All 660. 1929, 54 Bom. 226.

years or six years (Bombay) under different sections of the Act. The Act of 1936 terminated the confusion by prescribing 3 years which should run from the date of appointment of liquidator or misfeasance, whichever gives the longer period.

No single cause has been more responsible for the difficulties of banks in India than the dishonesty or incompetency of their management, particularly the directors. Yet, no cause is more intractable to human remedy. The law can be of use here only in a post-mortem manner. The fact is that the qualifications to be sought in directors are of such a diverse character that any legal definitions or disqualifications are impracticable. General or administrative experience, technical ability, ability to introduce business, local knowledge or influence, control over other businesses—these are some of the qualities which open the way to directorship. Yet, there can be little doubt that much less worthy qualifications play too often a decisive part in the selections. Concentration of power in a few hands or narrow social groups and cliques, interlocking of interests to a dangerous extent, predominence of old age or the hereditary principle, these are some of the crying evils of company management even in most advanced countries like England. Unfortunately, while it is easy to state the evils, it is not easy to suggest remedies. The vigilance of shareholders, which in practice is only a counsel of perfection, high standard of business morality and public character which are always slow to take root and grow particularly in a confused and heterogeneous soil like that of India these are the only ultimate basis of our so called financial democracy of joint stock enterprise. In the meanwhile, it may be feasible to give the Reserve Bank ex-officio representation on the boards of scheduled and certain non-scheduled banks as a guardian of public interests without the right to vote.

Till 1913, no qualifications were required of persons who acted as auditors. The Act of 1913 for the first time prescribed the certificate of the Governor-General as a

necessary qualification in the case of all public companies. The Act of 1936 requires the same qualification of auditors for those private companies which are subsidiaries of public companies.

The rest of the section purports to ensure the independence of the auditors. The auditor is appointed by the general meeting of the shareholders. In order to prevent any surprise displacement or appointment of auditors, a notice of 14 days prior to the meeting is prescribed. The directors may fill a casual vacancy. Unfortunately, the judges are not agreed on the definition of a casual vacancy. The remuneration of auditors is fixed by the general meeting which, however, may and does delegate the task to the directors with the words "at a remuneration to be agreed." A director, officer of company, partner of director, a person in employment of director or officer cannot be appointed as auditors. The Act of 1936 disqualified persons indebted to the company and auditors who became indebted subsequently to their appointment to the office.

By Sub-section 3, Section 145 of the Acts of 1913 and 1936, the auditor is relieved of the responsibility of examining the accounts of branches beyond the limits of India. It would appear from this by implication that he must attend and audit on the spot all branches within the limits of India. Such an inference is regarded as valid by some authorities on the subject.

Experience teaches that legal precautions to ensure the independence of auditors or wider powers conferred on them to obtain information are of little use in practice. Actual appointments are always made by the directors and there are forms of favour and bribery so subtle that they can never fall within the clutches of law. It may be that bank-failures are more due to the laxity of supervision and management than to inadequate performance of duty by auditors.* Nevertheless, no steps should be omitted which can make directors more alert and the public

* Central Banking Inquiry Committee Report, p. 470. Para, 728.

more confident about the security of their funds. Proposals have been made to arrange for an outside audit and examination which will extend beyond ascertainment of facts to advice and criticism. The Indian Companies Act itself empowers shareholders of a bank holding 1/5th of the shares to approach the local government for a sepecial investigation and report. The former suggestion has been disapproved as opening a loophole for shoving of responsibility from the management to outside examiners. The latter has proved futile in practice and incapable of improvement.* Other proposals like association of a shareholders' committee with audit, more frequent reports, etc., offer no better solutions. The proposals to make auditors liable for omission to state material facts in their reports and in the presentation of accounts of a bank are at best merely a post-mortem consolation. The only logical and final settlement of the vexed problem is to look on the audit of public companies as a public and national concern and to constitute a State service of accountancy for the purpose. A first step towards the goal would be to begin with banks, money-lenders and other cognate concerns and since the Reserve Bank is in direct charge of our banking welfare, it would be well to entrust it with the formation and management of such a service. Such an audit power has the additional merit of giving the Reserve Bank a closer insight into the banking situation from time to time and making its credit-control to that extent much more effective. The expenses of this audit could be easily raised from the banks themselves by levying a certain percentage on their resources.

Law relating to Organization and Management

One great difficulty of banking legislation is to define what a bank is. In the absence of such a definition, there must always be some doubt as to the exact concerns to which its provisions should apply.

English law which till 1936 governed banking practice in this country as much as in England makes no effort

* Ibid, p. 469. Para, 720; pp. 470-728; 724.

to give a precise definition of a bank or banking business. Nevertheless, it imposes obligations on all concerns which claim to be banks, like periodic publication of balance sheets, etc.* It has even created a penal offence in making an improper use of the phrase "banking business."† But whether a particular concern is a bank or not, English law is content to treat as a question of fact, to be determined in each particular case in the light of prevalent beliefs, methods and practices.‡

The Indian Central Banking Enquiry Committee, 1931, considered suggestions on this behalf from the Government of India, the Royal Commission on Indian Currency and Finance, 1926,¶ Provincial Enquiry Committees and several witnesses. It recorded its conclusion that "the task of defining the term 'bank' or 'banker' which has been regarded as well-nigh impossible in other countries, is much more so in India where a definition cannot be drawn up without excluding many firms of indigenous bankers and individuals who do a considerable portion of the financing of the country."§

Many countries have sought to meet this difficulty by requiring banks to incorporate themselves under special laws which aim at the regulation of the organization and management of banks and their supervision. Other countries like Italy and Germany have created special authorities to license banks and have specified grounds on which license may be declined or banks in actual operation may be closed. In Germany, another authority, a Supervision Board, watches and regulates the practices and internal management of banks.

The Indian Banking Enquiry Committee made a commendable effort to combine the elasticity of British practice

* Companies (Consolidated) Act 1908. Sec. 1; 108; 118; 251; 256.

† Moneylenders Act 1927. Sec. 4 sub-sec. 3.

‡ In Todd v. World of Finance Syndicate Ltd., Mr. Frederick Strusser, Assistant General Manager of London and South Western Bank, in evidence for the defendents, stated that the methods of the John Bull Bank were not those ordinarily adopted by joint stock banks. The jury found the verdict for the defendents with costs.

¶ Para. 162; The Commission proposed this definition: "The term bank or banker should be interpreted as meaning every person, firm or company using its description or title 'bank' or 'banking' and every company accepting deposits of money subject to withdrawal by cheque, draft or order."

§ Majority Report, p. 458.

with the certain protection of law on specific points. As we shall presently notice, it indicated certain points on which banking legislation was desirable. At the same time, it suggested the formation of a Bankers' Association whose membership should automatically create in a conspicuous manner the necessary assurance of reputable status and practice. Till such an Association came into existence, the committee proposed that banks should be required to take out licenses from the Reserve Bank of India, which must naturally insist on conformity to certain standards.*

The Indian Companies Act of 1936 adopted the bolder but more doubtful course. Section 277F defines a banking company as "a company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order." The qualifying word "principal" must itself create not a little embarrassment in the future. But, not content with this ambiguity, 17 clauses more were added to catalogue incidental businesses or business operations which banking companies may undertake within the bounds of law. The catalogue finds place for activities as widely different as agency business other than that of managing agents (unless the managing agency relates to a bank itself) at the one end and financing or promoting a business undertaking or industry at the other. It is obvious that if precision is the only virtue and justification of a legal definition, the definition adopted by the Indian Company Law cannot be accused of it.

One may well compare this assay in legal ingenuity with the definition offered by a great authority on banking law and practice like Sir John Paget.† After enumerating each specific characteristic, Sir John Paget finds himself compelled to recognise acceptance by public opinion as one if not the sole mark of a bank. This is tantamount to a

* Ibid, pp. 454-56.

† Sir John Paget in his "Law of Banking," sums up the legal decisions on this subject in the following manner :—

"No one and no body, corporate or otherwise, can be a 'banker' who does not (i) take deposit accounts (ii) take current accounts (iii) issue and pay cheques drawn on himself (iv) collect cheques, crossed and uncrossed, for his customers banking must be his known occupation and recognised by the public as much."

confession that banking is a dynamic process and that reputable practice as understood by contemporary bankers is the final court of appeal in every doubt.*

Organisation.—The Indian Companies Act, 1936 lays down that no banking company incorporated after the commencement of the Act shall commence business unless shares have been allotted to an amount sufficient to yield Rs. 50,000 as working capital.† We have already noted how the creation of banks with small, insignificant capital was a very usual device with charlatans and adventurers to defraud the public of its hard-earned savings. The restriction introduced by this Act undoubtedly terminates one grave scandal in the field of banking.

It is possible to claim some historical or logical justification for the minimum fixed. During the four periods over which we have studied bank-failures in the past, more than 3/4ths of the failures are accounted for by banks with a paid-up capital of 1 lakh and less. Of these defunct banks, those with a paid-up capital of Rs. 50,000 to 1 lakh were about 1/4th of the aggregate in 1913-14, about 1/6th in 1915-20, about 1/7th in 1921-30 and 1/10th in 1931-34. Banks with paid-up capital of Rs. 50,000 and less no doubt constitute the bulk of the problem of bank failures. The failures of those in the class immediately above this forms also a substantial though fortunately declining proportion of the whole.

* In the Draft Bank Bill, misuse of the words "bank," etc , or evasion of the banking sections of the Company Law is sought to be remedied in this manner. Banking is first defined as " banking means the accepting of deposits on current account or otherwise subject to withdrawal by cheque " and " banking company " is then said to be a company as defined by the Indian Companies Act icluding a foreign company which does the business of banking in British India. " No company which falls short of this definition may use the words " bank ", " banker " or " banking " in its title and companies which do the business of banking as defined must use the word in their titles. 18 sub-sections then follow stating " one or more......forms of business and no other which a banking company may engage in."

Before the recent amendment of the Indian Company Law, the evil which was sought to be remedied by such definitions was the misuse of the word " bank " by concerns which were only money lending institutions or something worse. In so far as this evil persists to-day, it is difficult to see how this definition can check it. Since it is not practicable to prescribe any minimum volume of current accounts etc., it would be quite easy to evade the definition by creating nominal current accounts and issuing cheque books. The 18 sub-sections referred to above are sure to give ample scope for any degree of imprudence or abuse of the word, bank.

It seems however that since the amendment of the Company Law, the former eagerness to use the words " bank " etc. has given place to a general desire to avoid these words. The object is to avoid certain obligations placed on banking companies like periodic returns of balance-sheets, maintenance of minimum cash reserves etc. As current accounts do not hold any important place in the business of these concerns, it seems doubtful how far forcing them to forego the use of the words "bank," etc. will mean an improvement in the banking situation of the country.

† See 277 I.

Since capital and reserve constitute the guarantee fund to the creditors of banks, it is logical that the fund should bear some proportion to the liabilities of banks. The fixing of a minimum does not satisy this logical test although it eliminates many doubtful and obscure ventures. Some countries have met both these difficulties by prescribing the minimum according to the population of the place where a bank is intended to operate. While population is no doubt a good index generally to the banking potentialities of a place, the criterion is obviously unsuited for countries in which branch-banking is allowed without restriction. We have had occasion already to notice how in India many banks with small resources of their own indulge in the creation of branches which cannot be justified by any canons of prudence or sound banking practice. It would not be feasible either to prescribe any definite proportion between their capital and reserves and their liabilities. In an earlier chapter, we have analysed how this proportion is influenced by factors outside as well as within the control of banks and by factors some of which are temporary in their incidence while others are more or less permanent.* Besides even though a bank may decide to make changes in its capital structure, banks like all other enterprises have to bide for opportune moments to appeal to the capital market. Perhaps, these were the difficulties which, in Spain, led to the conclusion that each bank should have its minimum fixed according to its special circumstances.

The Indian Companies (Amendment) Act, 1936, requires that every banking company should out of the declared profits of each year and before any dividend is declared transfer a sum equivalent to not less than twenty per cent. of such profits to the reserve fund until the amount of the said fund is equal to the paid-up capital. In other words, provision is made that banks with less than 1 lakh of owned resources should not exist in the future. The reserve fund must be invested in government securities

* Pp. 109-10

or kept on deposit in a special account in a scheduled bank.*

It is but fair that a part at least of the profits should be used to increase the security of the creditors and depositors who supply the bank the bulk of its resources. 20 per cent. of the net profits is by no means too large proportion. In view of the all too common tendency to declare high dividends and raise the value of bank shares to fictitious levels, this clause may prove a very healthy influence on banking policies. Nevertheless, a lower percentage during the first ten years of a bank's life with gradual increases every five years might have been a justifiable concession in favour of new banks.

Concentration of banking resources in a few banks contributes materially to the stability of a banking system.† In India, as we have noticed, banks have grown in size less by the process of amalgamation and more by creation of branches. This unrestricted freedom to create branches however brings with it its own special evils which require to be carefully inquired into and firmly dealt with. There can be little doubt that branch banking appeals to many disreputable concerns as a mere device to collect resources. Small and backward places are particularly exposed to this kind of exploitation.‡ It is also to be feared that Indian banks have not yet developed an efficient technique of running bank branches. This efficiency of technique rests on a fourfold basis—recruitment and training of qualified staff, a strict system of audit and inspection, adequate discretion to the local manager combined with a proper degree of regulation from the headquarters and finally, close contact and interchange of views and information between the local branch and businessmen. On every one of these points, Indian banks have yet to prove their capacity to adapt themselves in an original way to Indian conditions and limitations.

Till India reaches its maximum growth in banking facilities, some restrictions on the freedom to create branches seem unavoidable. The minimum conditions as

* Sec. 277K. † Pp. 21-27. ‡ Pp. [illegible]

to paid-up capital and reserves prescribed by the law of 1936 may by themselves act as a check on this evil. Our earlier analysis however has established how difficult it is to define or assure ratios of capital and reserves to deposit-liabilities which can operate effectively in different places and at different times.* It has been sometimes suggested or proposed that branches in the bigger places should be under an obligation to conform to certain special requirements as to capital. In other words, it is proposed to abandon the present principle of uniform minimum capital for the country as a whole and to introduce for the benefit of certain places the principle of wealth of the area of opration as the basis of capital requirements. It is arguable against this that protection is more required for the smaller and more obscure places than for big cities which always contain banks of great repute. The proposal is besides a denial by implication of the existence of business in the bigger places suitable only to small banks. A more logical and certainly more effective alternative will be to prohibit the expansion of individual banks to such an extent that the average of resources per office falls below a certain minimum. It may be recalled that this average for Indian banks of class A and B was about 7·7 lakhs in 1936. When the big seven banks were not taken into account, the average fell to about 3½ lakhs.† It should be no hardship for our banks which in future are required to show a minimum capital and reserve of Rs. 1 lakh, to have to produce at least a minimum of 3 lakhs per office on the average as proof of the confidence commanded by them.

A more difficult question relates to wasteful competition. It is probable that much of the recent branch extension is in the nature of a struggle among bigger banks not to be out-distanced by each other. If such competition lowers ultimately the cost of borrowing to the public, trade and industry are no doubt benefitted. But very frequently, the cost of uneconomic competition is transferred to the public in the shape of lower deposit-rates and higher cost of borrowing. It is more than likely that some of the bigger

* Pp. 106-16.
† Pp. 23-27.

financial centres are overcrowded with bank-branches and that in other places, indiscriminate competition has undermined the position of certain old and well-established concerns.

Within broad limits, population should be a simple and intelligible index to the banking potentialities of a place. If a greater degree of exactness were desired, the index could be adjusted so as to discriminate between places which are mainly industrial and possess a truly urban character and those which are mainly markets for agricultural produce and on that account retain a predominantly rural character. A little intensive investigation should be sufficient to fix appropriate ratios of population per branch from which departure should be permitted only under exceptional conditions. It is natural to think of the Reserve Bank as the proper agent for the regulation of branches on these lines. When applications for licenses to open branches exceed the maximum fixed by the population ratio, preference should as a rule be given to those banks which show a larger volume of resources per office. As for exchange banks and foreign banks generally, their unhampered extension into the interior has been detrimental to national interests and their further encroachments must be prohibited by law. The small economy of financing movements of goods from the interior to the ports and from the ports to their destinations abroad as a single transaction is nothing as compared with the greatest of all economies—the creation of a truly national banking system.*

* The Draft Bank Bill proposes to amend the minimum requirements as to paid-up capital and reserves in the following manner. A banking company is not to be permitted to commence business with less than Rs. 1 lakh as minimum paid-up capital. If a bank does business at Bombay or Calcutta, it must have in respect of each such place a minimum paid-up capital of Rs 5 lakhs. If it does business at places with a population of over 1 lakh, it must have for each place an amount of capital of not less than Rs. 2 lakhs. There are 38 places which have a population over 1 lakh. No bank with a paid-up capital and reserves of less than Rs. 20 lakhs will be allowed to operate outside the province or state in which it has its principal place of business.

Fifty per cent. of authorised capital must be subscribed and fifty per cent. of subscribed capital must be paid-up.

These proposals raise the following points. Depositors in bigger places which as a rule contain well known bigger banks are apparently presumed to require more protection than depositors in small places. Small banks as such have no special functions to perform in bigger places although they are known to contain many small crafts and industries. Banks in small places which as a rule are mere centres for collection of deposits are excluded from investments in bigger places which as a rule are chief outlets for investments. Small banks may have to develop a practice of placing their surplus funds with bigger banks or move into more ineligible kind of business. Perhaps, they may become branches of bigger banks. None but the big seven of Indian Joint-Stock banks could spread outside the provinces of their origin. In the case of the bigger banks, no restrictions are proposed on overcrowding of bank-branches in places with a population of 1 lakh and over.

A grave defect of Indian banks at present is the unsatisfactory way in which bank staffs are generally recruited, the unsatisfactory facilities offered for training and self-improvement and the unsatisfactory incentives held out to industry and ability. It is not possible to overstate the grave implications of this situation for the future of Indian banking. If the creation of a sense of national pride and confidence in our banks is our objective, nothing will achieve it more quickly than a well-founded public conviction that system and standards and not arbitrariness and disregard of merit and qualifications weigh in the selection of our bank personnel. The time has arrived when service in a bank should carry with it the same degrees of stability, assured prospects and fair deal as service in a State Department. In the matter of initial recruitment at least, the Reserve Bank and the scheduled banks could and should take the lead to devise in co-operation a common machinery on the lines of Public Services Commission. While shareholders may well claim their profits and the directors their power over the management of banks, the public who contribute the bulk of the working resources may well insist on employment in banks being dealt with as a public concern.

Management of Banks

We have insisted in various places that certain special features of banking business justify safeguards in public interests which may not be so expedient in the case of joint-stock enterprise in general. This argument has sometimes been extended to support a very strict regulation of the internal, day to day, management of a bank as well. Indeed, much recent legislation in many countries seems to suggest that law can take the place of that wisdom which according to Gilbart "implies a due proportion of all the faculties" and

that banking talent which according to the same authority "consists more in the union of a number of qualities, not in themselves individually of a striking character but rare only in their combination in the same person." If to the already formidable list of Gilbart, we add one more virtue, namely, honesty, the absurdity of seeking in law a means to banking success and stability becomes at once self-evident. As a matter of fact, a close examination of most of the aforesaid banking legislation will reveal that its object was more to allay panic and restore public confidence by means of a visible gesture than to force any departures on actual banking practice. In the case of India, certain special features of the situation make such legislative interference highly inexpedient.

It is true that legislation of this kind does not lack precedent in this country. The various charters of the Presidency Banks and the Imperial Bank of India furnish examples of regulation on almost every conceivable point—cash ratios, period and currency of loans, interest-rates, security, limits on individual loans, etc. But it must be borne in mind that these restrictions had one specific object in view—the safety of public funds which also constituted the compensation for the restrictions. Banking and financial needs of the whole country are however incapable of definition with reference to a single objective and could not for that reason be fitted into the framework of a general law.

Banks in India disclose highly regional and individual characteristics. According as they are regional or country-wide, their liabilities and assets show different composition and bear the mark of the specialised services they are performing. Besides, still on the threshold of our banking development, we have still to evolve a type of bank or banking system which really answers the special needs and

circumstances of the country. In countries like Germany, legislation was comparatively easier and harmless as banks had already reached their full banking development and were distinguished by a certain degree of homogeneity. Even if these difficulties were absent, it is difficult to conceive how law could permit the large degree of cyclical and secular adaptation which we have already remarked upon in our earlier analysis. The inflation of war years, the high interest-rates and reviving trade of post-war years, the dramatic fall of interest-rates and stagnation of trade after the crisis of 1929-30—these caused such profound changes in the cash ratios, investment policies, volume of loans, etc., of banks that it is difficult to make out how law could cope with them. Legislation must either prove futile or invite the very evils and disaster which it is intended to forestall.*

Our concern till now has been the good management and stability of banks which are in operation. The special difficulties arising out of legal and administrative procedure concerning banks which suspend payment are not less numerous, vexatious and from the standpoint of public weal, less urgent. Some of these difficulties have been already discussed by use in the course of our study. Liquidation of banks and disbursement of dividends to creditors engross as a rule not less than ten years and in some case, much longer periods even have been recorded. Although

* Pp. 112-38.

The Bank Draft Bill proposes that banks must maintain a minimum of 30 percent. of their time and demand liabilities in the form of cash or trustee securities as defined in the Indian Trust Act, excluding immovable property. In practice, 50 per cent. of the securities so held should be securities maturing in 10 years. This minimum reserve is not to be used as a security for advances except when the Government after considering the recommendations of the Reserve Bank, to suspend the operation of the Act for limited periods, either generally or with reference to a particular bank or banks may allow the Reserve Bank to advance against this minimum reserve to tide over a crisis.

Out of 40 Indian scheduled banks, about 25 are already maintaining more than the proportion suggested above in these liquid assets. It is noteworthy that even the Travancore Nationol and Quilon Bank in its balance-sheet of March 1938 i.e. just before its collapse, exhibited the required proportion. In the case of small banks, however, the proposed measure might mean a distintct improvement. Since liquid assets available for use must be in excess of the 30 per cent. minimum, a likely consequence of this step would be a tendency to reduce cash to the lowest minimum possible in order to maintain profits. The suggestion is in effect tantamount to the creation of a guarantee fund in addition to the capital and reserves of a bank, the price of which in the case of many small banks will be reduced dividends to the share holders.

facilities for reconstruction are defined in law, practical difficulties almost always frustrate such efforts. In many cases, indeed, such schemes of reconstruction are mere devices either to secure a continued lease of life for abuse of public confidence or to evade legal consequnces, which await a public investigation incidental to compulsory winding-up. Proposals for voluntary winding-up or even amalgamations are more often than not inspired by similar motives. The recent banking crisis in South India has raised another acute difficulty—conflict of jurisdiction between British India and Native State authorities and the danger of loss of protection by one of the parties to the unfair advantage of the other. It is clear that a rehaul of the law to suppress these evils cannot be deferred long.*

* The Bank Draft Bill proposes to deal with these questions in this manner. Inability to pay is defined as relating to one working day in a place where the Reserve Bank has an office and two working days elsewhere. On an investigation and favourable report to that effect the court may grant a moratorium not exceeding two months or may a stay a winding-up order when arrangements are made for paying-up the depositors in full. No voluntary winding up is to be allowed unless the bank is able to pay its depositors in full immediaetely Otherwise, the court is bound to pass orders for winding up when a bank is unable to pay. No meeting of creditors etc. need be called when it would mean mere expense or delay. To avoid the high cost of liquidation, the Reserve Bank is to be recognised as the liquidator in all cases of banks. The liquidator is to make the preliminary report within two months of the winding-up order and need not be held up for the sake of the statement from the office of the bank required under 117 A.

CHAPTER XI.

THE LONG TERM CAPITAL MARKET

EVEN if banks attracted nothing but temporary savings of the public and placed them in nothing but genuine short-term investments, their influence on the long-term capital market would not be less real or less than considerable.* As a mater of fact, however, their contacts with this market are in certain ways quite direct and in the aggregate, as decisive as those of other similar institutions. In the first place, banks have their long-term investments, changes in the volume and character of which are important factors bearing on the course of interest rates. Secondly, when banks offer their advice and services for security dealings or place their funds at the disposal of industry in anticipation of public investments later, or themselves embark their funds on such ventures, they become an important agency in the working of this market. Finally, with the creation of a central bank, an instrument is forged by means of which the long rate can be controlled almost as directly and as decisively as short rates.

The basic problems of long-term investment are two. In the first place, there is the problem of aggregate investment which should be such that it corresponds to the division of their incomes by consumers between saving and investments. In the second place, investment should flow into different lines of production in accordance with the index of profitability as given by the consumers' demand. As the first problem is generally believed to be one of monetary management, it is properly held to be within the sphere and constitute the responsibility of the banking system. As for the second great task of the investment market, the responsibility is at present shared by different agencies in different ways. Among them, the stock exchanges are looked on as the main mechanism developed by the capitalistic system. The promoter and underwriter, the banks

* Pp. 38-39; 58-60.

and issue-houses act as auxiliaries or supplementary aids to the stock exchanges.

I
STOCK EXCHANGES IN INDIA

Legal Status

Originally, stock exchanges were mere voluntary associations largely for the purpose of regulating fees and charges. It was not till after great lapse of time, that these associations recognised that they owed certain responsibilies towards the public. In the case of more recent bodies, which lacked experience and tradition to keep them in the straight path, law has had to step in as a substitute for that experience and tradition.

The London Stock Exchange is perhaps the only example today of an autonomous exchange unfettered by any outside restrictions. But the history of "Britain's Bourse for stock jobbing and securities" goes back to the days of Queen Elizabeth who herself inaugurated it amidst great pomp and patriotic fervour. Even, today, the London Stock Exchange has no legal monopoly of its business. The growth of Exchanges outside London in more recent times has indeed tended to creat some acute problems for the parent body.

The New York Stock Exchange was for a long time a voluntary body till in 1933 financial and banking collapse and public clamour compelled the Government to impose on it statutory regulation and registration. The Compagnie des Agents de Change of Paris is a privileged body created as such by law but Government tacitly tolerate breaches of its monopoly. The Berlin Stock Exchange is subject to a dual control firstly the Imperial laws of 1896 and 1908 and secondly, the Chambers of Commerce and State Departments.

Business in stocks and shares in Bombay appears to have begun quite long ago. Six brokers are reported as doing this business between 1840 and 1850. By 1860, the eve of the American Civil War, they had increased to 60. Among

them was one Premchand Roychand whom subsequent events were to link in an immortal manner with the financial history of the City of Bombay. The American Civil War brought great wealth to this cotton exporting port, wealth led to wild-cat enterprises and ignorant or fraudulent speculation, speculation attracted more members to the business of stocks and shares—to the tune of 200 to 250. The inevitable losses, insolvencies, exposures of fraud and cupidity do not seem to have diminished the attractiveness of the profession itself which reached a membership of 300 in 1877.

The formal creation of an association had however to wait till 1887.* In that year, the Bombay Stock Exchange as it is popularly known took its birth as "Native Share and Stock Brokers Association." The name selected caused some difficulties. The members of the association have never been brokers, pure and simple. The inclusion of the word "native" gave offence to patriotic sentiment and in the rules of 1938 was discreetly omitted.

Membership of Stock Exchange

Conditions attached to the membership of a stock exchange flow naturally from the functions which such an institution is meant to fulfil. These functions may be broadly distinguished under two heads. When a member acts as a broker to the public, he undertakes (i) to buy the scrip concerned at the lowest price or sell it at the highest price obtainable (ii) to offer his expert advice and guidance in matters of investment, according to the temper and inclinations of his clients and (iii) to establish and maintain more or less permanent relations with his clients and their families as their ever-present well-wisher and guide in matters financial. It is clear that this function calls for not only a high standard of skill and experience but what is most difficult to find, a high standard of honour and character as well. In the absence of these qualities, the individual with surplus income must hold back in distrust and prefer less economic forms of investment with great loss or waste of national

* An informal association was in existence from 9th June 1875.

savings. Every practical precaution has therefore to be taken to place the broker above temptation in the discharge of his proper duties. Two obvious principles suggest themselves. The broker's remuneration should be so defined that firstly, it should be independent of the price of the scrip which he buys or sells for his client and secondly he should have no personal interest in the scrip bought or sold. The first point is met if the broker's scale of remuneration is fixed from time to time with reference to particular scrips or classes of scrips according to the status and prevailing values of the scrips. The second point relates to the second main function of the stock exchange. When a member of the exchange acts as a jobber *i.e.* buys scrips on his own account or sells scrips out of his own stock, he is acting just like a dealer in ordinary commodities. His willingness to buy and sell at all times makes the supplies of the market more regular and makes periodic revisions of judgment possible. Since buying and selling are continuous, the jobber does not hold stocks with a view to speculate on likely price-changes. He looks for his profit and remuneration to the difference between his selling and buying prices and his skill lies in keeping stock from time to time just sufficient for the needs of the market and making his selections in such a way that fluctuations in the values of some are balanced by counter fluctuations in the values of others.

In the enrolment of members, the existing practices of leading stock exchanges vary much in the emphasis they lay on position in business, financial guarantees, technical qualifications, etc. The oldest of them, London, relies chiefly on personal introduction or membership of a reputable stock exchange firm. New York is satisfied chiefly with the financial guarantee and status implied in the purchase of the seat. The Parquet in Paris requires over and above purchase of a seat, firstly, a large contribution to the general guarantee fund and readiness to respond to further assessment on the same account and, secondly, proved knowledge of busines, law or banking.

Admission to the Bombay Stock Exchange is preceded by an inquiry into character by the managing committee and has to be supported by two existing members. By a rule which has been in existence from about 1927, a member is not permitted to deal with any non-member share or stock broker within a radius of 50 miles from Bombay. The obvious object is to prevent or discourage the growth of unauthorised business in this line.

The price of an admission card was originally fixed at Rs. 51 only but was raised subsequently to Rs. 1000. By 1909, the price of a card reached Rs. 2500 and after the outbreak of the Great War to Rs. 7000 in 1917. During the great speculation waves which followed, a card was recorded to have fetched as high a price as Rs. 40,000. Before the outbreak of the present war, the value of a card was placed at about Rs. 7000 but has since mounted up to Rs. 20 to 30 thousand. It is clear from this that the financial guarantee implied in the possession of a card fluctuates much from time to time. Indeed the record of recent defaults proves that most of the defaulters lacked the financial status desirable in a member of a stock exchange like that of Bombay. Of 28 defaults which occurred from 1927 to 1939, seats had to be forfeited in the case of 11 because the defaulters could not make good the loss sustained by members even though it ranged much below Rs. 50,000. Four other defaulters could pay only 6½ to 10¾ annas in the rupee although the loss at stake was on the same scale.* To assure a better safeguard against defaults, the proposal has been made that in addition to the purchase of a card, the new member should produce two sureties or make a deposit of Rs. 30,000 for a period of 2 years. It may be a better alternative to create a guarantee fund to which all members have to contribute and to which further assessment may be made in case of need. The fear that other members may have to bear the consequences of the recklessness of less worthy members will tend in the long run to great care in initial admission and the creation of a powerful opinion

* See foot-note, p. 387.

among the members themselves against undesirable practices and forms of dealings.*

A member of the Bombay Stock Exchange must not engage as principal or employee in any other business. It would be otherwise very difficult for the public or for his brother members to judge his credit worthiness or his financial position at any particular time. This restriction has been unfortunately felt as a grievance by many businessmen who are anxious to add stock exchange business to their other existing lines. The new institution, the Indian Stock Exchange is the outcome of this desire.

Till 1938, an admission card to the Stock Exchange was treated very much as an invitation card to an Indian wedding. Cousins, nephews and other relatives were held entitled to admission over and above authorised clerks. Henceforward, only sons of brokers and authorised clerks will be allowed to enter.

Sub-brokers

In addition to members, we have the institution of sub-brokers or remesiers. The Atlay report described them as mere unauthorised tipsters and touts who misled the public by their irresponsible canvassing and added to the demoralisation. Their status is now proposed to be regularised by requiring them to sever their connection with any other lines of business and to deposit Rs. 5000 on registration. The amount may be confiscated for reasons for which a member is liable to be expelled and his ticket confiscated. No limit is proposed on their number. But they must pay an annual subscription of Rs. 100 and when leaving one broker for another, must produce a clearance certificate.

The 1938 rule limits strictly the number of authorised clerks allowed to each broker. It is doubtful whether anything short of abolition of this element will eradicate some of the notorious evils associated with their activities.

* In 1933, when Currimbhoy Ebrahim and Sons Ltd., crashed, all active members whether involved or not in the dealings of Currimbhoy group, subscribed to a special fund to the extent of Rs. 3 lakhs and enabled the Exchange to meet all its liabilities.

Till almost 1938, a piquant feature of the general disorder and confusion of the Stock Exchange used to be the presence of hawkers, beggars and naturally enough, pick-pockets also. The Atlay Committee discovered even minors speculating on the floor of the Exchange. The difficulty, if not the impossibility of admission to the central floor of the London Stock Exchange is a queer contrast to the informality and even charitableness of the Bombay City. Recently, this evil has fortunately disappeared.

There were about 6 brokers in 1840-50. By 1860, there began to assemble, no doubt under the famous bunyan tree near the University tower, as many as 60 under the leadership of Premchand Roychand. The hectic speculation of American Civil War raised the number to about 200 to 250 many of whom were "broke" by the close of the war. The membership was 300 in 1877 and 478 in 1921. But of these, only 225 to 250 were active when the Atlay Report was made in 1924. At present the membership is about the same—the members on the active list being about 200.

If membership is any index to the size of an exchange, we may contrast this figure with the maximum membership of 4,000 in London and 1,100 in New York. The Parquet in Paris has a jealously limited membership of only 70 while the intruder Coulisse has about 100.*

Classification of Members

When a member acts as a broker, he is working as an agent of the public. He becomes a principal towards his customer when he acts as a jobber. These two essential functions of an orderly and trusted stock exchanges raise difficulties when the same member is allowed to act in these dual capacities. The conflict of interest and the strain on honesty are obvious and the extent to which they are resolved is a measure of the smoothness, reliability and effectiveness of the investment market of a country.

* See foot-note p. 394.

London has met this difficulty by a clear separation of brokers and jobbers.* As a matter of convenience, a broker who receives similar orders from two customers is allowed to cross them but then he may charge one commission only. Besides, as brokers frequently underwrite issues and consequently hold quantities of scrips they are also allowed to sell on their own account. But, in such circumstances, the brokers are expected to declare the fact to their customers and are not allowed to charge any broker's commission. New York has similar classes of brokers or commission houses, specialists or specialist dealers but as there are more varieties of members, the distinction is very much blurred in practice. In Paris, the Parquet deals only with the public as brokers but members of the Coulisse are allowed to trade among themselves also.

In Bombay, a member is allowed to work both as broker and dealer. There is little doubt that this double capacity has been the source of much abuse of public confidence or at least public suspicion. It is not easy however, to frame effective remedies. A separation of brokers and jobbers such as prevails in London depends for its efficacy largely on traditions of the profession. Collusion between brokers and jobbers is always possible and a separation forced on the members from outside is most likely to be rendered nugatory by such practices. It has sometimes been suggested, as another argument against separation, that the volume of business is not sufficient to justify such a step.† The argument lacks clearness. Since separation cannot reduce the present volume of business, the members could not be affected in that manner by such a measure. For every broker's transaction, there must exist as its counterpart a jobber's transaction and unless losses on one part are sought to be covered by manipulations of the other part of the transaction, there is no reason why members should not be willing to enrol themselves for prescribed periods either as brokers or dealers. It might be conceded, however, that as the aggregate of scrips listed

* "When there is a slump in the market and a rush of selling orders with no support as happened in rubber shares......the jobbers are apt to be at lunch all day and the brokers have to report to their clients that they simply cannot find a purchaser."

† See foot-note p. 394.

is less than 150 as against the enormous numbers appearing on the lists of London and Paris, specialisation does not offer here any proportionate advantage.

In the absence of such separation, other remedies tending in the same direction have to be sought. In the first place, lists of members should be drawn up to distinguish such of them as are willing to act only in one capacity from others who wish to adhere to the old practice. In any case, it should be presumed that in every transaction, a member first declares the capacity in which he is acting towards his client. In the second place, the contract note arising out of each transaction should specify the capacity in which he is acting. Till now, we have had only one form of contract note, the principal's contract note. A contract note, whether principal's or agent's, should give all details which explain the character of the transaction. The name and quantity of scrip dealt in, the rates of purchase and sale, the rate of brokerage charged, these should be sufficient to enable each transaction to be sifted and judged, should there be an occasion for such a procedure. In the third place, it has to be recognised that much the great source of present evils is the uneconomic and unfair competition which prevails among members themselves for the available business. The strict regulation of rates charged is the only conceivable check on such competition. Although minimum rates have been in vogue for a long time, it is to be feared that the levels at which they are fixed are so low as to defeat their main purpose. A revision has now been effected by the rules of 1938. More important than fixing the rates is their proper enforcement, which raises inevitably questions about the independence, impartiality and courage of the executive of the Stock Exchange.

Listing of Scrips

The procedure and conditions of admission of scrips to stock exchange dealings are a very pivotal point in the technical organisation of these institutions. It may perhaps be thought strange that restrictions should be thought

necessary for a stock exchange when they are not to be found in ordinary commodity markets. A little reflection should, however, show that there are some crucial differences between the two markets. In the first place, most commodities in ordinary markets are self-defined and easy to identify. In the case of scrips, frauds are far more easy. Even in the case of ordinary commodities, precautions have sometimes to be prescribed in order to ensure purity, quality, etc. The usual practice of stock exchanges is to prescribe a certain minimum period of existence before the scrip of a company is admitted to official dealings. The minimum period is sufficient to prove whether the enterprize is seriously intended or is a mere kite sent up by designing promoters, etc. In the second place, most commodities are abundant and world-wide in their supplies and what is more, there is large scope for mutual substitution. The scrip of each company is a unique commodity by itself and its supplies are more or less rigidly defined. The essential condition of a free market, that a single individual or a few individuals should not be able to exercise a disproportionate influence on price, is very hard to satisfy unless proper precautions are enforced from the very start. Stock exchanges seek to create such a free market by stipulating firstly that the company concerned should have a certain minimum of capital divided into shares of convenient denominations and secondly that a sufficient quantity of shares should be offered initially to the public at large. In order to assure the quality of the scrip, stock exchanges are not content with mere conformity to the Company Law but demand many more details before admission to the privileges of the exchanges. London maintain two lists, one official and one supplementary, demanding much more information in the case of the former.* Of course, it must not be imgained that a stock exchange can or ever presumes to sit in judgment on the nature of prospects of any individual enterprise. The assessment of the ultimate qualities and risks of each

* In Paris, with reference to mortgage bonds of the Memphis, El Paso and Pacific Rail road (1869) which were first admitted to the Parquet and later found by it to be fraudulent the Syndical Chamber was held negligent by the Courts and made to pay 1/15th of the damages.

scrip is the proper function of the investor which the stock exchange may facilitate but cannot itself assume.

Till 1938, the Bombay Stock Exchange restricted admission of securities by a rule that scrips registered outside the province of Bombay should not be put on its list. Besides, companies were required to take initiative in seeking admission of their scrips. The effect was a certain limitation on the volume of their business and a certain concentration on a few scrips. The rule regarding the maintenance of a register in Bombay has now been widened to cover the whole country while the prohibition to deal in scrips applies now to those companies only which have been positively debarred from admission. The application for admission may be made by the Company or by a member of the Exchange. The criteria of admission are "magnitude and importance" of a scrip and the offer except in unusual cases of at least 50 per cent. of the issue to the public.

Cash and Forward Lists

Deals on the stock exchanges may be either time deals or cash deals. Ordinarily, it should lie with the parties to the contract to decide whether it should be on a time or cash. Although time deals facilitate speculation, pure and simple, they are no less a convenience to genuine investors who may desire to avail themselves of particular, favourable opportunities for investment. The practice of our stock exchange in regard to this matter is rather peculiar. It maintains two separate lists for scrips for which cash and forward dealings are recognised. This places a special responsibility on the management of the body and inevitably raises the question as regards the appropriate considerations to be taken account of in placing a scrip on either list. So far as the rules of our local exchange are concerned, with one exception which we shall note presently, they vest unfettered discretion in the management both for initial assignment to the lists and subsequent changes.

Cash dealings have a natural tendency to be confined to those who are genuine investors or at least have the means to hold the scrip for a long time. Since a regular stream of investment is hardly to be expected, fluctuations in the values of scrips which figure largely in cash transactions tend to take place in an abrupt or sporadic manner. Time deals take place from day to day in terms of expected differences and as such appeal naturally to the speculator. Since only a large volume can give adequate profits and income, they are apt to be undertaken very largely with borrowed money. According as expectations materialize or the opposed groups make their power felt one way or the other, prices fluctuate very widely. On the other hand, it must be recognised that such speculative trading by itself acts as a support to the prices of scrips. A movement in one direction cannot proceed very far before a contrary opinion develops and counteracts the movement. Each level of values reached by a scrip tends to perpetuate itself for at least a considerable time. In the case of cash scrips, on the other hand, the market may not be a continuous one as judgments are revised only when investors turn up. The range within which values fluctuate is therefore apt to be a wide one.

This difference between scrips which are dealt in largely on a time or cash basis explains the positive exclusion of bank shares from the forward list. Banks are quite unlike other joint stock companies in that the resources with which they operate are withdrawable on demand. Fluctuations in the values of their shares are highly undesirable as likely to provoke unwarranted inferences and mass fears. Even in the absence of forward deals, bank managements have to keep a jealous eye on the values of their shares and many a time adopt policies as a concession to popular prejudices which strict prudence and long foresight would not approve. The shares of assurance companies and in a less accountable manner, the shares of railway companies also are placed entirely on the cash list.

In 1939, there were placed about 106 scrips on the cash list and about 31 on the forward list of the Bombay stock

exchange. The 31 scrips on the forward list were made up of three government securities, two electricity scrips, fifteen spinning and weaving scrips and eleven miscellaneous scrips. The only common quality of these scrips is the large interest which the public and particularly the speculators display in them.

Period of Settlement and Speculation

The time interval over which a time deal is spread varies from one stock exchange to another. In London and the Parquet in Paris, the settlements are fortnightly. The bulk of transactions on the latter exchange, however, takes place on a cash basis. On the Coulisse in Paris and in Berlin, settlements are monthly. On the New York Exchange, settlements used to take place every next day prior to the crisis of 1929 but since then the practice has been introduced of settling accounts every third day.

On the Bombay Stock Exchange, there are two settlements a month for dealings in government securities and one settlement a month for all other forward deals.

The time interval over which forward deals are permitted and settlements enforced has a certain limited significance for the tone and character of a market. A long interval makes assessment of the future more difficult and gives irrational calculations much larger scope. A short interval means earlier opportunity to revise judgments and, if necessary, to withdraw before the situation deteriorates much further. It might appear that this is a rather dubious advantage since transactions can always be carried over. But a little reflection will show that even with the facility of carrying over, the shorter interval still retains most of its advantage. Carrying over has its own automatic check in that it involves some cost as contango or backwardation. It is of course true that mere imprudence or recklessness cannot be remedied in this manner. But this is no argument against improvements devised to diminish defaults arising out of honest mistakes or misfortunes. That a shortening of the interval is by itself incapable of moderating extreme fluctuations in values, speculation and

wide-spread defaults is more than proved by the frequent experiences of the New York Exchange.

Margins and Speculation

It is the practice in certain stock exchanges to enforce margins from customers. The prime object of such margins is to protect the broker from losses since his is the ultimate responsibility in case of default by the customer. There are no margin deals on an organised basis in London. The tradition there has been to depend very largely on the personal knowledge of the customer. Margins are availed of very freely on the New York Stock Exchange. On the Parquet in Paris, margins of 20 and 30 per cent. are prescribed according to the character of the scrip and the broker may enhance the margins in case of need. There is no practice of margins on the Bombay Stock Exchange. The Atlay Report described it as undesirable but the Morrison Report has suggested its adoption.

The main effect of a system of margins on the outside public is to repel persons with inadequate resources from stock exchange deals or to prevent them from assuming burdens out of proportion to their means. The justification of its adoption must naturally depend on the extent to which such persons are accustomed to participate in such adventurous speculation. It has been claimed on behalf of the Exchange that cases of this nature are very few and far between. It is not improbable that there is some substance in this claim. Members of the Stock Exchange cannot be interested in assuming financial responsibilities for such cientele. When, however, those who oppose margins adduce the further reason that their adoption must eventually create irregular and illegitimate markets outside the stock exchange, they involve themselves in an obvious contradiction. If men who engage in time deals at present are as a rule men of resources, the demand for margins should not have any such effect as is feared. If irregular and illegitimate markets do emerge, it will be only because even at present there is a large number of financially weak parties who participate in this activity. If the adoption of margins

does lead to this result, the situation will be on a par with those which exist on account of the prohibition of betting, gambling, etc., and should have to be dealt with an identical manner. The innovation could be given a trial for an initial period of ten years and then finally disposed of in the light of actual experience.

Prices on Stock Exchanges

It is generally presumed that the objective expression of the existence of a single market in a commodity is uniform price. As a matter of fact, uniform price for a commodity is an ideal to which actual conditions rarely show even an approximation. The ideal price when analysed really resolves itself into a number of objective conditions which may be briefly stated as a high degree of standardisation of the commodity dealt in, a high degree of concentration in time and place, a relative insignificance of the influence which any individual or a cotery of individuals can exert on price.

The stock exchange as a market in titles to capital is distinguished by certain features which seem to run counter to these conditions. On the supply side, each scrip is no doubt a highly standardised commodity by itself. But, at the same time, each scrip is unique by itself and cannot take the place of another. It would hardly be an exaggeration to say that from the standpoint of aggregate supply, there are as many markets in a stock exchange as there are scrips and securities traded in. This has a very important effect on daily dealings and therefore on daily prices. Offers to buy and sell any scrip are as a rule sporadic and separated by intervals of time. Continuous variations in supply, demand and prices such as make for stabilisation in other markets are not to be found in a stock exchange.

Except in Berlin, each transaction takes place on all other exchanges as a separate bargain, which results for reasons given above in its own special price. This creates the problem of recording daily prices in such a manner as to make them intelligible and useful as indicators. In London, prices are marked individually while for listed

securities, the closing prices of the last half an hour are published. Paris quotes prices in the order of actual deals while dealings for account have their first and last and their highest and lowest prices only published. It is clear that such records are bound to be too inadequate or too copious to indicate the prices at which the bulk of transactions takes place.

Fixed prices are used only for carry over transactions in London. New York uses the opening price of the day for this purpose, which however, is frequently revised. Paris uses the average of actual prices.

Berlin has made an original, profound and instructive effort to obviate the effects of lack of concentration in time to which all stock exchanges are subject. Each individual bargain does not take place at its own time and at its own price. All orders for sale or purchase have to be submitted in the first instance to official brokers. At the appointed time, the official brokers start to make bids and counter bids and out of these, they frame regular schedules of demand, supply and prices. They are thus enabled to fix that unique equilibrium price at which according to the strict theory of competition the largest offers of sale coincide with the largest offers of purchase. It is clear that the system is justified only in so far as accuracy in price fixing is attained. In the most favourable circumstances, such an achievement presupposes an elaboration of technique and degree of intelligence which are not easy to secure.

Level of Values Generally

Day to day prices or cyclical trends in values are intelligible only as deviations from some conceivable basic level of values when considered over more or less long periods. Scrips represent ultimately the fixed assets or capital-goods and good-will of an enterprise and it appears natural to presume that their prices follow the general movements of prices. Yet, the assessment of appropriate values of

scrips and the differences between them invol[illegible] complications than are present in the cas[illegible] consumption goods. The subject may be [illegible] three heads.

(1) The profits or dividends [illegible] are the most obvious factor to be taken [illegible] assessment of their true meaning—how far they [illegible] the fundamental stability and soundness of a concern and how far they are merely fictitious is however not an easy task. It calls for much experience and technical knowledge in interpretation. Extraneous factors like taxation, etc., have also to be allowed for in degrees of varying nicety.

(2) Any particular level of dividends or profits has a significance only in relation to the general level of dividends or profits. The best representative of this level is the long term rate of interest on investments which are free from risks and therefore typify the productivity of capital in general. It is clear that with a rising trend of long-term rate, the values of scrips will tend to be depressed and with a falling trend, they will show a certain persistent buoyancy.

(3) All investment partakes more or less of the nature of a leap into the known future. Expectations of future profits are for this reason a more important influence on prices than the attraction of past profits. These expectations necessarily take account of a bewildering number of factors—the potentialities of a particular concern, the prospects of an industry in general, trends of currency and banking policies, trends of interest rates, all political and non-political incidents which affect the course of trade and industry. It is of course true that anticipation of the future in this sense is inherent in every economic activity and indeed in all details and spheres of human life. Yet, of few other markets could it be said as of the stock market that speculation is the most outstanding influence in valuations and sometimes indeed in

a degree which is little distinguishable from gambling, pure and simple.

It is natural that all weakness of human psychology in regard to the unknown should be exhibited in their raw and crude form in the field of investment. Paradoxically, our so-called forecast of the future is but a projection of our present experiences and moods and it is not surprising that our pre-occupations with the living present however trivial and insignificant in themselves, should throw out of perspective our view of the future.* Fear and hope, perhaps fear more than hope, originating in our present experiences create a mental state in which rational computation has little chance.

Since it takes more than one person to speculate, it is clear that gambling as the extreme form of speculation is a social phenomenon. The standards of honour and respectability prevalent in any social group have therefore an important effect on the extent to which gambling is made a source of individual and family fortunes. As in many other lines, it happens that in India business in stocks and shares tends generally to be confined to certain narrow castes and communities of the Indian society. It is an inevitable outcome of this situation that an economic psychology of a self-perpetuating character and impervious to new influences from outside should have grown in which stricter judgment of character, behaviour and modes of life find little place. When we reflect that most persons are virtuous not because like Socrates they prefer virtue

* The influence of interest-rate, varying demand and expectations relating to different commodities, the course of inflation etc. is well illustrated by the course of prices of scrip during the last war.

	29th July 1914	26th July 1917	26th March 1918	27th March 1919	31st March 1920
5 Government Securities ...	100	70	67	74	62
100 Port Trust and Municipal Debentures ...	100	89	84	84	91
10 Banks ...	100	106	112	116	137
32 Jute Mills (ordinary) ...	100	311	467	383	563
65 Cotton Mills (ordinary) ...	100	132	162	157	336
30 Coal Mines (ordinary) ...	100	136	184	157	140
1 Woolen Mill ...	100	106	125	125	137
37 Tea Companies (ordinary)...	100	127	125	123	136
4 Floor Mills ...	100	137	206	238	406
Tata Iron and Steel (ordinary)	100	332	295	284	307

See also p. 53 foot-note for effect of a depression.

but because of penalties of detection and social disapprobation, the importance of this factor in certain regrettable aspects of our dealings in stocks and shares is easily discernible. The infusion of new and better educated elements into the Stock Exchange should in the course of time prove the solvent of many of our present evils.

The fool cannot be prevented from his follies—much less the gambler. But this is no reason why opportunities for such behaviour, particularly when it ensues in anti-social consequences, should not be curtailed to the minimum compatible with the free flow of legitimate business. Still less could it be a justification for placing temptations in the way of persons who but for them might prefer cautiousness to recklessness. It is to be feared that the seamy side of stock exchange business in this country and particularly in Bombay has been in no small measure due to certain practices which weakened deterrents to rashness and anti-social activities. Affairs have been administered and powers have been used in the past in such a way as to suggest that the institution exists only for the benefit of its members and recognised no responsibility to the investing public and the country.

Default

Till recently, the penalties of default were seriously limited in their deterrent value. Default was rcognised only against a fellow-member and not against a member of the public. Besides, the property of a defaulter outside the stock exchange was not available to meet his liabilities incurred in deals on the exchange.* The 1938 rules remove

*	Number of defaulters.	Max. and min. loss to members (000s)	Penalty.
1927 ...	2 ...	27 to 20	Seats forfeited.
1928 ...	1 ...	48	" "
1929 ...	3 ...	25 to 35.	" "
1930 ...	1 ...	33	" "
1933 ...	7 ...	16 to 377	3 seats forfeited and others pay 5 to 10½ annas in the rupee.
1934 ...	2 ...	144 to 280	1 seat forfeited and one pays 5½ annas in the rupee.
1935 ...	1 ...	6	Seat forfeited.
1936 ...	3 ...	11 to 109	2 seats for feited and one pays 12 annas in the rupee.
1937 ...	3 ...	74 to 146	0-10 annas in the rupee paid.
1938 ...	5 ...	34 to 266	4 seats forfeited and one pays 10 annas in the rupee.

these defects in both these respects. A defaulting member is not to be re-admitted to membership now if the default was caused by speculation on his own account. In other circumstances, when the conduct of the defaulter has been above blame, he is re-admissible only if he has met his liabilities in full. Exceptions may be made in case of clear misfortune. It is self-evident that the beneficial effect of these amendments will be in proportion to their proper enforcement.

Expenses which have to be incurred in deals of stocks and shares are also no mean factor in encouraging or discouraging speculation. Movements in prices of certain scrips, especially seasonal movements, can always be foreseen with a fair degree of accuracy. No advantage can however be taken of them since these movements are more than offset by incidental expenses of the transactions. It is a natural extension of the logic of this fact that where incidental expenses are heavy, speculation on narrow margins of price fluctuations is effectively repressed. It has been suggested of the London Stock Exchange that one cause of less speculation there than in New York is that the incidence of brokerage, transfer fees, stamp duties, ect., is markedly heavier. From this standpoint, the practice of blank transfers on the Bombay market must be counted as another factor making for speculation which has no social or economic purpose.

Intervention in the Ordinary Course of the Market

Powers of intervention in the ordinary course of the market can only be justified by some special factors which distinguish deals in stocks and shares from deals in other commodities. The chief usefulness of speculation, it will be recalled, lies in enabling future stocks to be taken into account in fixing present prices. Whenever possible, speculation enables supplies to be adjusted to forthcoming changes in economic circumstances. In the case of stocks and shares, the only adjustment in supplies relates largely to scrips of new enterprises. New enterprises and their

scrips take, however, a long time to establish themselves and in the meanwhile, holders of scrips of older enterprises find themselves confronted with exceptional opportunities of gain, when the demand is enlarged, and loss if the decline of demand has created the necessity of contraction of output. In the second place, since the market for each individual scrip is unique by itself, individuals are sometimes able to acquire complete control over supply and prices and thus terminate the existence of a free market. Thirdly, hedging is an important facility which ordinary markets offer. Speculation is the means to eliminate speculative risks from production and manufacture for future delivery. In the case of stocks and shares, hedging from week to week or from month to month has clearly no economic basis. Intervention in the ordinary course of the Stock Exchange may be justified to the extent that these special features lead to any anti-social consequences.

Selling-out Rule

The suspension of the selling out rule is intended to arrest a bear raid and prevent further falls in prices. Obviously, the power is invoked to protect bulls who are confronted with heavier and heavier losses as the market drops down. Such intervention seems however to have only slender justification since there exists an automatic check in the market to a fall which is not warranted by inherent economic facts. When prices fall so low that yield rises above the economic level, buyers must make their appearance in larger and larger numbers. If buyers hold off, it will be only because bulls have raised prices to very uneconomic levels and considerable downward movement must take place to reach economic levels. The establishment of economic levels is certainly a pre-requisite of healthy investment and the penalties borne by the bulls in the process are decidedly a well-merited chastisement which should lead to more responsible behaviour in the future. It has been sometimes argued that depreciation of securities might embarrass legitimate trade and business which use them for raising loans. It is improbable that

such counters are accepted by lenders as security except at very safe margins. The existence of this power was properly condemned by the Morisson Report.*

* The following record illustrates the intervention of the authorities in the more important corners, crises etc. which bring out incidentally the great part played by causes and persons outside the Stock-exchange in most of its difficulties.

1898. One Raghunath Mulji cornered the shares of Lakhmidas Mill and raised their price from Rs. 1,000 to 1,800.

A little later, a corner raised the price of shares of Queen's Mill from Rs. 1,000 to Rs. 1,200 and then in a single day, the price fell to Rs. 800.

Jehangir Byramji Dalal effected a corner in the shares of the China Mill and raised the price from Rs. 1,000 to Rs. 2100. Dalal was made a partner in the Managing Agency.

1896. Chunilal Saraiya, assistant in the Hundi Department of the Bank of Bombay and others intimately connected with the Mill cornered the shares of the Sun Mill and raised their price from Rs. 150 to Rs. 650. The stock sold by the bears was found to be more than three times the stock issued. The President intervened and the liabilities were settled at a price of Rs. 500.

1910-12. Rivalry between uncle and nephew led F. Petit to buy the shares of Manekji Petit Mills at a price of Rs. 3,950 and sell them for the next settlement at a price of Rs. 3,800. For the first time in its history, the buying-in rule was suspended. Petit agreed to a compromise and received the difference on the basis of Rs. 3,800 per share.

1913. The aforesaid J. B. Dalal cornered shares of Petit Mills. The banking crisis brought matters to a head. Dalal failed with the collapse of the Credit Bank. On the earnest representations of the Board, members who had sold sharse at Rs. 3,200 repurchased them at Rs. 2,600 and resold at Rs. 2,000—thus suffering a loss of Rs. 1,200 per share.

1919. The managing agents in concert with others effected a corner in the shares of the Madhavji Mills. Forward deals were suspended. There were two defaults by members in the year and four more in the subsequent year.

1921. Mathuradas Gokuldas and his Syndicate cornered the shares of Fazulbhoy Mills. While the issued shares were only 7,200, 14,000 Kaplis were applied for. A corner was declared and price was fixed at Rs. 2155. The Syndicate sold 6,000 shares to Sir Fazulbhoy Currimbhoy at Rs. 1,650 c. d. i. e. at a price higher than market price which had fallen to Rs. 1,400.

Later, a partner in the Agents' Firm and others connected with the Mills effected a corner in the shares of the Finlay Mills. A low dividend of Rs. 25 was first declared and shares purchased at the depressed prices. A dividend of Rs. 125 was then declared and although the shares issued were only 8,000, the purchases amounted to 16,000 and more. After the corner, the price fell from Rs. 1,880 to Rs. 950.

1922. Emboldened by their previous successes, the syndicate of Mathuradas Gokuldas attempted a corner in the shares of many concerns, Kohinoor, David, Currim, Bharucha, Swadeshi, Nagpur etc. A member of the syndicate was also involved on the Cotton Exchange. Forward deals were stopped in Nagpur and Swadeshi shares and prices were fixed. For the first time, a corner failed on the Stock Exchange and Mathuradas Gokuldas had to part with the Managing Agency of as many as five mills. One of the directors of the Stock-Exchange was broker to the syndicate and as such did not vote on the decisions taken. The Board passed a resolution that such directors must resign or may be removed by a two-thirds majority of the Board.

1922 October. A corner took place in the shares of the Currim and David Mills. While the shares issued were only 16,800, the amount sold exceeded 48,000. The syndicate sold David shares at Rs. 1,350 which was much more than market price to Sir Sassoon who thus got the Managing Agency while Currim also was mortgaged to the same parties.

1928. E. D. Sassoon and Co. Mills were sold to a syndicate for 6 crores. Preference shares were reserved for E. D. Sassoon and Co. while ordinary shares of Rs. 4 crores were loaded on the gullible public at good premiums. As a matter of fact, the book-value of the concerns was about 2½ crores and real value perhaps less than 2 crores. The shares of Rs. 10 nominal value collapsed to Rs. 3 immediately there-after.

1929, June. The exchange suspends all dealings.

July. The onset of the crisis and depression saw all deals for account suspended and resumption was delayed till October.

1933. The old Managing Agency Firm of Currimbhoy Ebrahim and Sons failed and six companies were involved. Members whether dealing in the shares or not subscribed to a special fund of Rs. 3 lakhs and all liabilities were duly discharged.

1935. Difficulties were caused by the Italy-Abyssinian war and dealings for account in government securities were suspended. The step was approved by banks, businessmen etc.

Men who lost in the Bullion Exchange crash tried to recover by a great bear raid on the Stock-Exchange where the realizations to meet losses on the Bullion Exchange were already depressing prices. Forward deals were suspended but cash deals continued.

1937. The currency depreciation and cheap money boom of middle thirties was abruptly reversed by rumours of return to the gold standard, threat of penal legislation in the U. S. etc. There was a general collapse of prices in April, May on the Bombay Exchange.

1940. An expected boom was suddenly destroyed by government announcement of an excess profits tax. Four defaults were announced.

Buying in Rule

The power to suspend the "buying in rule" exists to operate in the opposite circumstances *i.e.* when bears have sold more stock than is available in the market and the ensuing concentration of supplies in the hands of the bulls enables them to dictate any prices. In such conditons of a corner, the automatic check of an increase in supplies is no longer operative. Suspension of the rule prevents any further rise in prices and has a tendency to attract such supplies as are still floating outside the market. The threat to terminate the suspension, when prices must fall, inclines bulls to propose more reasonable terms and bears to accept them.

In the light of the foregoing analysis, it may well be doubted whether forward deals have any important economic function to perform in the interests of the economic system. Most of the situations envisaged above and the remedies considered seem to have a bearing only cn speculation among members of the stock exchange themselves. The elimination of forward deals altogether, the introduction of banks as members of the stock exchange as in Berlin, a rigorous enforcement of conditions of admission to stock exchange quotation, strict restrictions on the proclivities of directors and officers of companies to manipulate and speculate in their own script,* these and other measures are the proper means to solve the investment problems of this country. It is instructive to note that the Calcutta Stock Exchange recognises no forward deals and the absence of this mechanism has not caused any inconvenience to the great industries there.

Holidays

Arbitrary declaration of holidays has been a very common device on the Bombay Stock Exchange to evade the consequences of critical situations. The Atlay inquiry revealed that in a certain year the Exchange was closed completely for 155 days, was open for two hours on 144

* Appendix 20. Representation of the Bombay Exchange to Morison Committee.

days and recorded full working on 66 days only. When the authorities of the Exchange were not inclined to fall in with the demand for closing, broker's clerks took the law into their own hands and declared holidays. As usual, religion furnished the most easily available excuse for this anti-social behaviour. Under 1938 rules, these holidays are now limited to Sundays, December 27 to 30 and not more than 5 other holidays to be fixed by the Association at its discretion.*

The Board of Directors are authorised to close the market at their discretion for not more than 24 hours. It is made clear that this authority is to be used to meet country-wide emergencies or international crisis like war, etc. A domestic crisis is spcifically excluded from the exercise of this power. An extension of the closing period requires the prior consent of government through its appropriate department.

Banking Funds and Stock Exchanges

We have noted that the character of each money market varies according as there is a smaller or larger scope for loans to bill-business, business in stocks and shares, and, in countries where banks are more or less localised,—interbank needs. In London, the larger proportion of call loans generally finds its way into the bill-market. But in New York where the banking system lacked centralization of reserves and central banking facilities for a long time, the device of settlements every next day seems to have been adopted as a means of placing funds in an easily withdrawable manner. Even after the operation of the Federal Reserve System for more than a quarter of a century, the stock exchange continues to absorb the bulk of available short-term funds. It is possible that these sporadic injections and withdrawals of funds according to the needs of banks is an important factor in the well-known instabi-

* Many holidays are an amiable weakness of the Indian people. Early in the present century, bank holidays at Abottabad were found so numerous that the clientele protested that it would be less of a nuisance to them if postcards sent to them intimated working days instead of holidays! A bank manager at Jullundar keen on joining a cricket team at Amritsar promptly put up a holiday notice. A run on a bank which required 48 hours to bring cash from the nearest big town was staved off by means an announcement of two days' holiday.
Commerce. 27th May 1938.

lity of values on the New York stock exchange. In other countries, loans to the stock exchanges tend to approximate to the periods of settlement while the bill and discount market furnishes the banks with access to the funds of the central bank.

It has been sometimes suggested that a large participation in loans to the stock exchanges makes the banking system vulnerable to the ups and downs of security markets. The belief seems hardly well-founded. When banks make such loans, it is their practice to protect themselves with quite conservative margins. So long as this precaution is observed, there is no reason why banks should incur losses on this account. Experience proves that brokers' loans are the most liquid and reliable of investments. What difficulties have been encountered relate to loans to customers for that purpose. Looking at it from the standpoint of the economic system as a whole, it is the irresponsible and panicky behaviour of funds from non-banking sources which has caused grave embarrassments on the stock exchanges. Recent legislation in the United States is partly directed to squeeze out these non-banking sources from at least the official business on the stock exchange and to concentrate loans in the hands of banks.

There is nevertheless a sense in which loans to the stock exchanges are a weakness to the management of the banking system as a whole. Speculation on stock exchanges is speculation in price-differences. At certain times, the anticipated changes relate from one day to another and are apt to range over several points. Interest-rates as high as 10 per cent. and even more mean nothing more than an insignificant fraction of a rupee for a day, week or month and as such are hardly calculated to check the course of events on the market. No effective means could be found either to enforce any special rates of interest for the stock exchange which will not be evaded or impinge on other parts of the economic system. This inability to control stock-exchanges is a contrast to the ease and effectiveness with which interest rates reach the economic system through the medium of the bill and discount market.

It is sometimes thought that loans to stock exchanges implies a diversion of funds from legitimate trade and industry into speculation. The belief is founded on a misapprehension which becomes clear when we follow the trail of such loans. If such a loan is used to buy an existing security, one of two things must happen. The receiver of the price may use it to repay a loan to a bank in which case indebtedness has been merely shifted from one person to another. Alternatively, the price realised may be used by the previous holder for consumption purposes which means that the borrower must ultimately pass the scrip to some one with new savings. In either case, the loan to the stock exchange has not affected the distribution of resources between saving and consumption. If the loan is applied to the purchase of a new scrip altogether, the bank has either supplied capital in anticipation of new savings or if the new scrip does not turn out well has enabled the speculator to finance his loss. To the extent the investment is justified, funds have been usefully applied to trade and industry. To the extent that the judgment has miscarried, there is a loss of new savings for which banks cannot in any way be saddled with blame. Unless banks undertake the direction of investment by acting as brokers, advisors or underwriters, their responsibility could not extent beyond making funds available whenever sound and reliable security is offered.

No statistics are available of the extent to which the Bombay Stock Exchange is dependent on funds from banks. It is probable that loans from banks do not hold any important place in these dealings. Much of the speculation is undertaken by members on their own account and the funds are derived very largely from private sources.*

BOMBAY STOCK EXCHANGE

* Value of Shares bought and sold as per Brokers' Lists.
(figures in lakhs)

Year.	Minimum in 12 months.	Maximum in 12 months.	Total for 12 months.
1932 ...	5,20	10,99	91,77
1933 ...	9,94	33,62	256,14
1934 ...	16,17	58,86	400,17
1935 ...	41,25	84,66	621,35
1936 ...	28,61	55,20	585,82
1937 ...	57,08	141,25	1150,01

II

THE BOMBAY BULLION EXCHANGE

Investment in precious metals has always held a great place in the Indian economy. It would be difficult to say whether the chief motive in the growth of this practice was the desire for ornamentation or for a secure store of value. It may be presumed that for all practical purposes neither motive could have grown to the strength it has without the presence of the other. This fact gives ground for the hope that if either of them is weakened on account of social or economic changes, the practice as such will disappear much more quickly than many people have dared to hope.

Continuous absorption of precious metals as a store of value is indeed inherent in the economic situation of India. In highly industrialised countries, the alternative to precious metals is houseownership which holds before the eyes of the ordinary man the very same assurance of solidity and tangibility with the additional attraction of some income as far as one may care to see. Till recently, India as a land of villages lacked this outlet for investment of the savings out moderate incomes. In advanced countries like England and the United States, house-building is estimated to absorb as much as half the annual national savings. In India, illiteracy, ignorance, insecurity, etc., may have aggravated the inclination to seek shelter in precious metals but the main cause has been the absence of alternative forms of investment.

We have seen already that in more recent times, other forms of investment have been gaining very rapidly over this primitive way of storing value. Of total visible investments, the proportion invested in gold and silver has declined very impressively—although the absolute absorption in normal times still remains very large.* Indeed there is ground for the assertion that purely economic factors and economic consequences relating to movements in and out of precious metals have not received their due attention while the part of the steady, unvarying social factors has been correspondingly exaggerated. Of course, harvests,

* Pp. 11-15.

agricultural prices, festive and marriage seasons, etc., have been always reckoned in estimating the demand for metals and profits of the trade. But one factor has been generally left out of account and its economic implications not properly assessed, namely, the course of the exchange rate.

A rise in the exchange rate is tantamount to an immediate reduction in the price of gold. Many people are tempted to take advantage of the apparent cheapness by their converting other forms of savings into gold and silver or foregoing a part of their normal consumption in order to add to their stocks of the precious metals. These artificially stimulated imports have to be paid for and actually result in a larger volume of exports than usual. This should explain how during a period of appreciation of the rupee like 1923-26, our ordinary imports did improve but exports actually outstripped them in a paradoxical manner.

In other words, the harm from an appreciating exchange may not be visible in an actual striking increase in imports and a reduction in exports. The harm may take the shape of placing a premium on unproductive investment in precious metals and causing unnecessary exports in order to acquire the metals.

A fall in the exchange rate reveals itself immediately as an increase in the price of gold. Two different development are recorded in our history.

The prolonged fall in the exchange rate between 1871-93 illustrates one type of development. The rise in the price of gold caused a perceptible decline in the imports of gold. While a part of the resources thus saved may have gone into consumption, much the larger part seems to have converted itself into silver rupees. With silver as our standard, the price of silver in contrast with that of gold remained unchanged and thus brought it into favour. Almost all the silver imported in these years found its way into the mint although only a part was added to the circulation. People preferred to hold their savings in form of currency rather than as ornaments.

The decline in imports of gold and an increase in the expenditure on consumption may have been a part of the explanation of the striking increase of imports as compared with exports which was noted as a paradoxical feature of those years by the Herschell Committee.

When sterling and with it the rupee left their gold basis in September 1931, the situation was materially different. Among other changes, the advance of price of gold had come after a long period of 30 years of relative prosperity during which the country had acquired a stock of gold of more than Rs. 500 crores. The rupee was now a token coin and the rupee price of silver followed the same direction as gold price. The sensational increase in the price of gold and some increase in the price of silver were no ordinary temptations to make profits while the boom lasted. In six years after the abandonment of the gold standard, gold averaging to Rs. 50 crores per annum left the shores of India.

There can be little doubt that a small part of this windfall was used for consumption *i.e.*, to support the volume of imports. A large part found its way into investment. From 1931 to 1935, imports on the whole show much less elasticity than exports. There is nothing, however, in the composition of our imports to warrant the belief that we imported more capital goods in these years than formerly; the imports represent the usual consumption and investment demand. The agricultural classes generally seem to have lost in favour of those classes which invest their savings in banks, postal saving deposits and cash certificates, life assurance policies, etc. Currency made redundant by the severe fall of prices may also have replaced the former gold hoards on quite an appreciable scale.

The Bullion Exchange

It is natural that a market should have developed to facilitate these enormous dealings in precious metals. The Bombay Bullion Exchange originated in the regular trading which used to take place once on the pavements and footpaths of the Kalbadevi area. Systematic trading

began with the foundation as late as 1923 of the Bombay Bullion Exchange. As in the case of other markets, the discipline and control of this Exchange cannot be described as strict, although the Association has its manual of elaborate rules. Arbitrary closing of the Exchange has sometimes been complained of.

Conditions in the Bullion Exchange are so inherently different from those on the stock exchange that both in organisation and in general atmosphere the former presents quite an impressive contrast. In the first place, Bullion Exchange deals only in two commodities, the qualities of which are uniform and easily ascertainable. Secondly, prices of these commodities are determined in all ordinary circumstances by international conditions and some times, specific laws of particular countries. As a rule, they fluctuate within narrow margins or in a manner which may be accurately foreseen by the instructed. It has been also claimed on behalf of the exchange that members have avoided difficult situations by refraining from undertaking operations on behalf of persons of doubtful financial standing. These conditions make for a more even tenour of trade as also a less elaborate kind of organisation.

Traders in Bullion Exchange fall into two classes, members and brokers. None but members are admissible to the forward ring. Another difference between members and brokers is that when a party to a contract fails, the member is bound to fulfil the contract. A broker placed in the same circumstances need only forego his commission and has no further penalties to incur.

Deals are undertaken under two forms of agency. In Katchi Adat, the member merely brings together the outside client and the bazar party, charges the prescribed commission and incurs no liabilities for the ultimate fulfilment of the contract. In Pakki Adat, the member, although acting on behalf of an outsider, is a principal to the contract. He may be called upon to buy or deliver the bullion as the case may be, or in the alternative, to pay the difference. When a member sells bullion on behalf of a

client, it is customary for the latter to draw a hundi on the member.

The unit of transactions on the exchange is the same for cash as for forward business namely, 250 tolas for gold and 2,800 tolas for silver. But in the case of gold, the fineness prescribed is 90 fine for cash and 100 fine for forward business, a margin in the case of the latter up to 94 being allowed. In case of unusual difficulties in delivery, the exchange has been known to alter the fineness to facilitate fulfilment of contracts.

The exchange has a fixed scale of commission for all business. For ready deals, the commission is 3 pies per tola in the case of gold and 1 anna per 100 tolas in the case of silver. For forward business, the scale is 3 pies per tola for gold and 14 annas per 2,800 tolas for silver.

The most important activity of the exchange is dealings in options, the so called teji and mandi transactions. 'Put' as usual is the right to sell bullion at the agreed price at some future date. Obviously, the party which buys the right expects that the price on that specific date will be less than the agreed price. 'Call' is the right to buy bullion on similar conditions and is founded on the expectation that the price on the future date will rise. The agreed price is usually the market price of the day and the period of the option is generally between a fortnight to two months. The advantage of "put" or "call" lies in this if the expected change in the price is frustrated, the purchaser of the right may forego its exercise by paying down its price and thus limit his loss to the price. If a "put" were purchased at a price of annas 4 per 10 tolas, the maximum loss per unit *i.e.*, the standard bar of 2,800 tolas could be only 280 x 4 annas, *i.e.*, Rs. 70. If the change in the price of bullion is so adverse that the exercise of the right will mean a loss of more than Rs. 70, it would be advantageous to forego the right and pay the penalty of Rs. 70. The actual deals are much more complicated since "put" and "call" are combined in a most bewildering manner of ways.

The Bank of India is in charge of the clearing system of the exchange. At the close of each account period, the Board of the Exchange fixes the making up price. If a member fails to deliver the bullion, the buyer buys it at the auction and the seller has to bear the price difference. The loss to the seller is, however, limited by the rule that he will not pay per 100 tolas more than Rs. 3-8-0 above the market price fixed at the auction for the next settlement. The advantage of a corner to raise the price against the seller is thus severely restricted. Perhaps the fact that the price of the commodities cannot under normal circumstances widen very much makes such regulation practicable and effective.

III

LIFE INSURANCE

In analysing the disposal of our annual savings, we have recorded how life assurance funds have grown in a remarkable manner since 1920 and how the pace has been more rapid since 1930. The figures available for the latest year 1937 reveal that the aggregate life assurance business in force is 277 crores for private companies and 19 crores for the post office insurance scheme. The aggregate premium income for the year *i.e.*, the contribution of the public towards life insurance in that year exceeded Rs. 15 crores as against 6¾ crores in 1928.*

There is little doubt that there is still a good deal of scope for further expansion in this kind of investment. Some indication on this point is offered by the average sum assured in the new policies from one year to another.

	Indian Companies. Rs.	Non-Indian Companies Rs.	Post Office Insurance. Rs.
1929 ...	1,628	3,086	1,890
1930 ...	1,484	2,970	1,610
1931 ...	1,764	3,400	1,690
1934 ...	1,528	3,213	1,978
1935 ...	1,541	3,418	2,070
1936 ...	1,504	3,148	2,157
1937 ...	1,485	3,089	2,150

*	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937
Total Assurance in force ...	135	155	168	184	...	...	232	252	279	296
Premium Income ...	6.8	7.9	8.6	9.2	...	...	11.3	12.9	13.9	15.1

The Indian companies are obviously supporting the main burden of reaching the less well-to-do classes of our people. In a country where about 42 lakhs of account holders in the postal savings banks show a per head claim of Rs. 193 only, an average sum assured of about Rs. 1,500 is still relatively high. Besides, the figures for the last few years do not disclose any tendency to fall, which suggests that new and lower income-classes have yet to be persuaded to adopt this form of saving.

The manner in which insurance companies invest their funds is bound to be a factor of growing importance in the long term capital market. The following distribution of their funds by Indian life assurance companies which account for 184 crores out of a total business in force of 296 crores in 1937 should be sufficiently illustrative of the point.

	1937 (figures in crores.)*
Indian Government Securities	28·2
Municipal, Improvement Trust Bonds ..	5·2
Mortgage on Property	2·1
Land and House Property	3·2
Shares in Industrial Companies	4·1
Total	32·8
Other Investments	23·1
Grand Total	55·9

* This distribution of assets does not give an accurate picture of the practice of the majority of Indian Companies. For, the figures are inclusive of the Oriental Insurance Company which accounts for about half the investments. It invests very largely in government securities and for the reason quotes the highest premium rates. The exclusion of Oriental Insurance Company alters the percentage share of each type of investments in the following stricking manner.

	Percentage to Total Investments.	
	All Indian Companies	All Indian Companies ex-Oriental Assurance Co.
Loans and mortgages ...	14	16
Indian Government Securities	51	35
Other Gilt-edged Securities ...	12	15
Shares ...	6	10
Landed and House Property	5	7
Miscellaneous ...	12	17

It is clear that insurance companies although in a much stronger position than banks are in no way more venturesome. While investment in government securities is essential to a certain extent, these concerns could easily cultivate some of our neglected fields of investment like industrial debentures, house building societies, etc. At present, their contribution to the great task of cultivating new invesment habits lies only in life insurance as such.

IV
POSTAL SAVINGS BANK & CASH CERTIFICATES

Post office savings banks and postal cash certificates are the most far-reaching agency created by government to attract the small investor in this country. First established in 1882, postal savings banks supplanted before the close of the century the pre-existing district savings banks and the Presidency towns government savings banks and today they show 230 head branches and 11879 sub-branches. The extent of their operations will be better realised when it is recalled that towns with a population of 5000 and over aggregate in India to about 2300 only.

The limits on deposits than can be made in any single year and the total balance that can be held by a single depositor are now Rs. 750 and Rs. 5000 respectively while the limit for balance in the accounts of minors is Rs. 1000 only. Various suggestions have been made to raise the limits, allow deposit and withdrawal by cheques, facilitate joint-accounts and payment to survivors, increase the number of offices, extend as in the United Kingdom the local obligation to pay or receive into a general obligation valid in all parts of India etc. As we have already stressed, joint stock banks now offer similar facilities and inducements with the result that the growth of savings deposits has been most remarkable.* The limits, for example, fixed by the Imperial Bank of India for its savings bank accounts are Rs. 5000 in any single year and Rs. 10,000 for the maximum balance permitted in an account. Not more than one withdrawal is allowed per week.

* Pp. 13-15; 217 ;Table XXI, XXII, XXV and XXVI.

We have had occasion to remark on the enormous growth of small savings which has occurred since 1930. The growth in the case of postal savings has occurred very largely by an increase in the number of depositors. About 8 lakhs in 1900, the figures stood at 18 lakhs in 1920 and 24 lakhs in 1930. Although the number of banks has not varied much since 1920, the number of depositors rose to more than 42 lakhs in 1938-39.

The average balance in each bank has naturally kept pace with the growth of the number of depositors. But it is noteworthy that the deposit per head which was fairly stable or slowly progressing till 1930 mounted with astonishing speed in the depression years thereafter. Several causes of varying import have been at work to bring about this result. It is more than probable that fixed deposits at banks have lost their attraction with the great fall of interest rates. A part of the improvement is accounted for by the phenomenal exports of gold, hoards being to an extent converted into this form of savings deposit. A third cause which might explain the contrast between the behaviour of fixed deposits and postal savings deposits is that with the great fall of prices, the number of well-to-do persons *e.g.*, assees to the income-tax ceased to grow while the margin for saving of those classes which depend on fixed or relatively inelastic incomes was very much enlarged.* These remarks hold good for postal cash certificates also.†

V

THE RUPEE DEBT AND GOVERNMENT BORROWING POLICY

In almost all countries which are now in the van of industrial and economic progress, the creation of public debt led the way to the investment habit which became subsequently the foundation of their commercial and industrial achievement. Since the political dependence of India on England made this country an outlet for the investment of British capital, it was hardly to be expected that the growth of a domestic investment habit should have any

* Pp. 55-56.

† p. 109

place, whether as the most important bye-product or a part of the main objective itself, in the policy of public loans. As a matter of fact, it was the settled belief and policy of the government of this country before the world-war that not more than 5 crores could or should be raised in the Indian market in any single year. It was only under the stress and compulsion of the world-war that the potentialities of the Indian market were first properly assessed and in the short space of three years 1917-1919, loans aggregating to more than 130 crores were raised. In the ensuing years of deficit budget, reconstruction expenditure, development of railways, irrigation, forests, reclamations and many other miscellaneous objects of provincial concern, the experience of the war proved a turning point in policy and the same steady rate of borrowing, about 30 crores a year, was maintained till the onset of the Great Depression in 1930.

A little before the outbreak of the world-war, about 1910, an important change took place in the relative attractiveness of the two markets. A persistent disparity between the prices of rupee security in India and sterling security in England made it clear that so far as India was concerned, the United Kingdom had become a dearer market to borrow in. This dearness, explained in various ways, has become even more marked recently and is bound to work as an overriding factor in all our future borrowing.

The great war initiated a trend in interest-rates which has changed the composition of our public debt. It was obvious that the high levels caused by the war could be only temporary and must in due course be followed by a more or less long period of falling rates. Funds were therefore raised by means of terminable loans which account today for the bulk of our public indebtedness.

As the bulk of our public debt is covered by productive assets like railways, irrigation works, etc., it has not the regrettable meaning which it has in many other countries. It is true of course that the expenditure of these loans could have been so managed as to expedite the creation and growth

of Indian industries in the place of British industries. But apart from this omission, it could not be argued that our public debt deprived private trade and industry of the resources it needed more urgently. It would be more legitimate to criticise our borrowing programme on the ground that it took no account of the condition of the market and the state of trade and business generally. Our loans and programme of public investments have been so timed that they have sometimes aggravated the pressure on funds and at other times, avoided taking advantage of idle savings and assisting investment. In the years of abundant funds 1930-38, for example, government showed themselves keen on conversion operations and in no year did the tender of cash accepted in the loans exceed 20 crores. In most years, the tender accepted fell much below 15 crores.

So long as borrowing is undertaken for productive purposes and the credit of the government is high, the public debt performs an important service towards banking and business. It supplies the market with the most markettable kind of security. Ordinary banks find in it a means of cyclical or secular adaptation while the central bank depends on it within the limits of its character or law, for open market operations. Individuals and business look on it as an investment and the most dependable means to raise loans.

On 31st March 1939, the aggregate rupee debt of the Government of India and provincial governments stood at about 440 crores and the sterling debt at about £300m. To the rupee debt, we must add the loans of independent bodies like the corporations of Bombay, Calcutta, etc., which have statutary powers to borrow directly on their own account. The rupee debt of governments thus was more than twice the average note-circulation and more than one and a half times the fixed and current deposits of banks with a paid-up capital of 1 lakh and more. It is very unlikely that of the aggregate public debt of India, more than 150 crores of the rupee debt was held by all commercial and co-operative banks put together. If the export surplus of the war years were now used to repatriate our foreign debt, a great

opportunity will have been availed of to widen greatly our security market.

VI

AGRICULTURE AND LONG-TERM CAPITAL†

The supply of long-term capital to the peasant and cultivator is one of those economic problems of India which have yet to be dealt with on any significant scale. With the money-lender and other indigenous agencies of rural credit, there hardly exists a distinction between short-term and long-term finance. In spite of changes of law and status, their mutual relationships still retain the basic elements of a hereditary joint enterprise. Co-operation which aspires to replace these ancient agencies has avowedly concentrated itself on the supply of seasonal or at the most intermediate credit. There is a general agreement that long-term finance must be undertaken by a special type of organization like land-mortgage banks.

It is unlikely that one uniform type of credit agency will be able to satisfy the long term needs of different classes of agriculturists. The big landlord or zemindar should be able in all ordinary circumstances to raise funds from commercial banks in the country. For the small agriculturists, mutual guarantee, and intimate knowledge and association implied in co-operation are probably the only basis on which funds could be raised and banking operations managed with success. A partial modification of the co-operative basis may be necessary to the extent that the short-comings of agriculturists in business ability, knowledge, etc., have to be remedied by the admission of non-agricultural persons into the management and organisation of such institutions. As the Banking Enquiry Committee well observed, "While mutual knowledge of, and control over, one another among members is the insistent feature in the case of the unlimited liability credit society, the insistence in the case of a land mortgage credit society with limited liability is on the capacity and business habits of the directorate in order to ensure sound valuation of security, careful investigation of titles, correct assessment of borrowers' credit and repaying capacity and efficient management of affairs."

† See pp. 177-180; 280-83.

In 1937-38, there were 166 land mortgage banks in British India and 35 more in Native States. Only a few provinces and States like Bombay, Madras and Mysore have central land mortgage banks while the bulk is composed of primary land mortgage banks or societies.* The share capital, debentures, and loans received from central banks and societies of the aforesaid 166 societies in British India aggregate to less than 2½ crores. Provincial governments have appointed their officers on the management of these banks and services of officers of the revenue or co-operation departments have been placed at their disposal.

In defining the area over which these banks or societies have to operate, physical difficulties of transport, etc., have to be carefully weighed. The Punjab and Bombay provinces have adopted the same territorial unit, the tehsil or Taluka and more often the district. In Madras, a radius of 5 miles is judged more appropriate and there is a further tendency to limit the banks to fertile areas. Where the district is selected as the area it has been found that the bulk of applications is drawn from the area in the neighbourhood of the headquarters of the banks, the more distant tehsils or talukas finding the procedure more expensive or not easily available.

Equally with management, finance is the crux of the problem. It is clear that share capital cannot furnish more than a fraction of the working fund. It may not be practicable or indeed desirable to depend on short-term deposits for investments which must extend over 10 to 20 years, if not indeed longer. In Bengal, deposits running from 2 to 5 years have been raised. But it is still a question to be decided whether it would not be wiser in the long run to prohibit the acceptance of deposits or at least to limit them as to currency, volume, etc.

The flotation of debentures must, therefore, be the chief means of raising the necessary working funds. The success of debentures depends entirely on the status of the authority which issues them or on the guarantees offered.

* (a) Boroda has a central L. M. Bank but it deals directly with agriculturists. So also some other States like Cochin and Travancore.

(b) In Bengal, the Punjab and the C. P., Provincial Cooperative Banks act as provincial land mortgage banks.

Since primary banks can hardly command the requisite prestige and credit, the central land mortgage bank as in Madras seems to be best qualified to undertake the responsibility. The guarantees in vogue are of two kinds. In some cases, the provincial government have given guarantees as to either principal or interest or both and in Bombay and elsewhere have even subscribed to them. In most cases, the debentures enjoy the privilege and status of trustee securities. The other form of guarantee consists in the limitation of the issue of debentures. It has been suggested that the volume of debentures should not exceed 15 to 20 times the paid-up capital of the issuing mortgage banks or 1/2 the value of property mortgaged to them. As primary societies cannot float debentures, their working fund is composed largely of loans from central land mortgage banks.*

Safety of funds is sought not only by conservative management but also by various restrictions on lending. It has been the practice in Bombay not to advance more than half the value of mortgaged property. In Bombay and Bengal, loans are further limited to 10 to 20 times the share capital of the borrower. In the Punjab, the limit prescribed is 30 times the land revenue paid by the

*	Capital and other liabilities. (in 000s)	Percentage of pd-capital to 1.	Percentage of Debentures to 1	Percentage of loans from C. C. L. M. Bank to 1.
Bombay Provincial Co-Op. Land Mortgage Bank Ltd. ...	2100	19.6	77.1	......
Nasik Dist. Co-Op. Land Mortgage Bank Ltd. 1938 June ...	118	10.9	......	77.1
Surat Dist. Co-Op. Land Mortgage Bank Ltd. ...	158	18.9	......	78.1
Dharwar Dist. Co-Op. Land Mortgage Bank Ltd. ...	230	4.7	......	77.8
Belgaum Dist. Co-op. Land Mortgage Bank Ltd. ...	184	10.8	......	88.1
Pachora Taluka Co-op. Land Mortgage Bank Ltd. ...	259	4.9	......	74.9
Hubli Co-op. Land Mortgage Bank Ltd. ...	173	8.7	......	89.6
Poona Dist. Co-op. Land Mortgage Bank Ltd. ...	260	8.0	......	88.7
East Khandesh Dist. Co-op. Land Mortgage Bank Ltd. ...	158	16.7	......	80.8

borrower. It has been suggested that the maximum advance should not exceed a certain figure, two, five or ten thousand being mentioned. Periods for which loans should run are defined variously in different provinces. Equated payments are spread over 16¼ years in Madras while periods of 10 to 20 years or 20 to 30 years are either suggested or in vogue in other provinces.

The question of management and co-ordination is, as stressed above, not less important than that of finance. Defaults, accumulation of over-dues, favouritism in the grant of loans, the misuse of their position by directors to secure loans for themselves are evils to which these societies are as prone as the ordinary co-operative credit societies. The spirit and working of central co-operative land mortgage banks no less than the needs of agriculture would obviously be better served if joint stock banks were persuaded to become members of the central institutions. A more difficult and urgent problem is to co-ordinate the working of mortgage banks and ordinary co-operative

		* Percentage of applications granted to total applications.	Loan per applicant.	Percentage of loans due from members to liabilities.	Cash and Bank Balances. Percentage to liabilities.
Nasik Dist. Co-op. Land Mortgage Bank Ltd. ...	1936	19.7	1,418	......	......
	1937	46.8	1,118	92.4	......
	1938	60.8	1,080	87.5	1.3
Surat Dist. Co-op. Land Mortgage Bank Ltd. ...	1937	26.7	1,282	......	......
	1938	21.9	2,990	......	......
	1939	......	2,164	83.8	0.6
Dharwar Dist. Co-op. Land Mortgage Bank Ltd. ...	1936	......	1,875	76.3	6.9
	1939	14.7	1,586	74.7	......
Belgaum Dist. Co-op. Land Mortgage Bank Ltd. ...	1939	......	......	90.7	2.7
Pachora Taluka Co-op. Land Mortgage Bank Ltd. ...	1939	......	823	74.8	......
Hubli Dist. Co-op. Land Mortgage Bank Ltd. ...	1939	......	......	89.6	......
Poona Dist. Co-op. Land Mortgage Bank Ltd. ...	1935 to 1939	34.8	1,170	...... 91.5	...... 1.7
East Khandesh Dist. Co-op. Land Mortgage Bank Ltd. ...	1935 to 1939	14.5	1,350	86.6	1.8

credit societies. Their mutual co-operation cannot but be of mutual advantage. At the same time, every precaution has to be taken in order that only solvent and well-managed societies of the latter class should be admitted to such participation in the activities of mortgage banks.

In the existing circumstances, the main service of land mortgage banks must be to release the small land-owner and cultivator from his load of past indebtedness. In other words, the debt to the private money-lender with its high rate of interest is to be replaced with a debt to the land mortgage bank at a lower rate of interest* and an arrangement for systematic repayment has to be enforced. It is obvious that this alleviation of burdens will be a genuine service to agriculture only to the extent that high rates of interest are the chief cause of the agriculturist's continued indebtedness and he is willing to adopt a higher standard of business ethics towards land mortgage banks. Till this vast load of indebtedness inherited from the past is liquidated, questions of improvement of land, technique of production, etc., must stand inevitably postponed. As a matter of fact, the bulk of the present loans of land mortgage is intended for liquidating old debts incurred largely for non-productive purposes.†

* The primary banks in Bombay Province lend to their member borrowers at 6 per cent. hile the Provincial Land Mortgage Bank lends them at 4½ per cent.

† In Percentages of Total Loans.

	Loans for repayment of Old Debts.	Loans for Land Purchase or redemption.	Land Improvement.	Percentage of recoveries to dues.
The Punjab. 1920-30 ...	46.8	46.8	6.2	......
Nasik Dist. Co-op. Land Mortgage Bank Ltd. 1936-38	94.3	4.1	......	91.0
Dharwar Dist. Co-op. Land Mortgage Bank Ltd. 1936	......	......	......	42.4
Pachora Taluka Co-op. Land Mortgage Bank Ltd. ...	94.8	5.3	......	89.8
Poona Dist. Co-op. Land Mortgage Bank Ltd. 1935-39	87.3	0.9	4.8	......
East Khandesh Dist Co-op. Land Mortgage Bank Ltd. 1935 to 1939	......	......	......	65.4

EPILOGUE

As we arrive at the conclusion of our study, India finds herself entangled in another great war. While none can predict the course of events, there can be no doubt that, as the conflict prolongs itself, Indian banking will show increasing marks of it. At this early stage, we could only attempt to indicate broadly the conditions which must shape the immediate future.

It is unlikely that the Government of India will sever the link which ties the rupee to the sterling. The foreign exchange market of London and with it the foreign trade of the United Kingdom are, however, being subjected to more and more restrictions. The sterling link has therefore little significance for our trade with the United Kingdom which was its main justification. The main question in this aspect of our economy is how the United Kingdom proposes to pay us for the excess of our exports which she must purchase from us at whatever prices. The acquisition of all foreign securities in the United Kingdom by the British Treasury and the power taken by it to purchase them at their market value suggest that the same course could be adopted towards India. The sterling securities held in London on account of the Indian debt to Britain should be acquired in the same manner and used to discharge the commercial liabilities to this country on account of the war. India has a right to claim, at least at this late stage in Indo-British relationship, reptriation of her debt held abroad.

With a rigid control of foreign exchanges, England is free to shape her currency and credit measures with exclusive attention on her domestic exigencies. Her efforts are now concentrated on securing resources for war by direct curtailment of consumption instead of indirectly by means of inflation and rise of prices. The position of India and the objectives of her policy are and should be inevitably different. With her trade with non-European countries still largely open, the depreciation of her exchanges with non-sterling countries and the war demand

for her commodities have caused a rapid rise of price-level till by December 1939 the pre 1929 level has been attained. The questions with which we are now confronted are how far we shall permit prices to raise and whether, to hold them in check, we shall link ourselves with more stable currencies like the dollar and or adopt unusual measures like general export duties and subsidies to some if not all of our imports.*

Questions of domestic development are no less important and urgent. The war demand is essentially a demand concentrated on consumption goods and destruction goods. While the prospect of immediate profits is bound to cause an over-expansion of these industries, it is doubtful whether such over-expansion is in conformity with the true long-run interests of this country. Measures are necessary to assure an adequate supply of capital to and investment in those lines of production which are sadly lacking in this country and for which war offers unusual opportunities. This necessitates, however, a substantial reversal of a free economy policy. When leading countries of the world are belligerent and regiment their economies for the purposes of war, the free economies of other countries run the danger of being themselves harnessed and subordinated to the schemes and requirements of the belligerents. In circumstances like these, the autarchy of belligerent countries has to be confronted with some measure of national planning by others, if only to escape consequences of the former.

In spite of some stiffening, largely psychological in the long-term rate, open market rates have continued more

		* 194=100 India (Calcutta)	1926=100 United States.	1930=100 United Kingdom.
1929—Oct. Dec.	...	137	...	...
1939—April-Aug.	...	100	76	98
Sept.	...	114	79	106
Oct.	...	118	79	111
Nov.	...	131	79	117
Dec.	...	137	...	...

Dollar Exchange.

		Cents per Rupee.	Cents per Sterling.
1929	...	36.202	485.69
1932	...	26.347	350.61
1939—Aug.	...	34.407	461.07
Sept	...	29.923	399.51
Oct.	...	30.296	401.05
Nov.	...	30.127	392.47

or less at their low level. The period of peace had ended, as we have noted already, with bankers' investments in government and other securities at unprecendentedly high levels. As war demand for commodities enlarges the volume of borrowing by trade and industry raises customers' rates, securities must tend to be replaced with loans and advances. To the extent that government borrows unproductively, it will aggravate this shift of long-term funds into employment as working capital while the extent to which sterling debt is repatriated may work as an automatic check. The more open market rates are held low, the greater will be the pressure for loans and the usual spiral of inflation and rising prices will ensue. Long-term investment in the meanwhile will continue at a low ebb.*

With a rigidly controlled foreign exchange market and a scale of relative demands furnished by a definite objective like the prosecution of war, interest rates in England have only a formal significance. With a largely uncontrolled economy like that of India, interest-rates are a real and active force of regulation. With a continuous upward pressure on short rates, we are confronted with the question how far long-term investment is to be allowed to lag in order to facilitate the supply of war materials from our existing industries.

The war economy has to cope with shortage in many requirements some of which only have an equal significance for life in peace-time. Ship-building, machinery of various kinds, chemicals of all kinds are relevant examples. Prudence dictates that India should concentrate on the creation of these industries rather than exploitation of existing industries for profits arising out of war. Such a policy presents a two-fold problem. A part of the flow of economic

	* Inter-bank Call rate (Bombay.		Three Month's deposit (Bombay)		3½ per cent. Paper Yield.		
	1938	1939	1938	1939		1938	1939
ec. 1st week ...	½	1¼	1½	2	Aug.	3.58	3.62
2nd week ...	1	1⅝	1¾	2¼	Sept.	3.62	4.11
3rd week ...	1¼	2	2	2½	Oct.	3.56	4.13
4th week ...	2¾	1⅞	2-2¼	2¾	Nov.	3.56	4.03
End ...	2¾	2¼	2½	2¾	Dec.	3.56	3.99

resources into production of commodities which offer immediate profits but have little significance for the future must be diverted into these new industries as long-term investment. Excess profits tax and export duties are examples of measures which could be employed for this purpose. Secondly, as private enterprise is not likely to be attracted in war times into such entirely new ventures, it has to be decided whether the State itself should undertake the initiative or depend on subsidies, administrative control and actions, etc., to secure the objective.

As things are, the demand deposits of scheduled banks show a striking upward trend in the first three months of the war while fixed deposits have actually declined a little. The proportion of advances and discounts to demand and time liabilities reveal a fast growing demand for short-term accommodation which has been supplied entirely out of a reduction in investments. Cash and balances with the Reserve Bank have, if anything, moved on a higher plane.*

Much more significant is the expansion of cash which occurred to stimulate and support changes in the volume of cash held by the public and price-level recorded above.

The initiative of scheduled banks accounts for a part only of the expansion. Scheduled banks can add to their cash in two ways. They can withdraw their deposits at the Reserve Bank to the extent that these are in excess of legal requirements. Secondly, they may raise loans and advances, discount and sell domestic bills or dispose of similar assets acquired abroad to the Reserve Bank. Between August and December 1939, the deposits of scheduled banks have fallen by about 8 crores, loans advances and bills discounted or sold at the Reserve Bank record an advance of about another 8 crores while the balances held abroad by the Reserve Bank have risen by about 5 crores. Corresponding to these three items aggregating to about 21 crores, there is

*	Demand-Deposits. (lakhs.)			Scheduled Banks Time-Deposits. (lakhs.)			Advances and Discounts. (% of demand & time liabilities.)			Cash (% of demand and time liabilities.)		
	Oct.	Nov.	Dec.	Oct	Nov.	Dec.	Oct.	Nov.	Dec.	Oct.	Nov.	Dec.
1938 ...	134	134	131	106	106	107	45.2	44.3	47.2	11.7	9.5	7.7
1939 ...	139	142	145	100	100	102	47.5	49.2	55.5	10.4	10.7	9,

a fall to the same extent in the volume of Notes and Coin held in the Banking Department.

The greater part of the expansion of the cash basis has occurred at the initiative of the Reserve Bank itself. As against a steady sterling exchange at 1s. 5-15/16d. from July to December 1938, the rate in 1939 advanced to 1s. 5-63/65 d. in October, 1s. 6d. in November and 1s. 6-1/64d. in December. To counteract this buoyancy, the Reserve Bank acquired sterling securities to the extent of about 37 crores and issued notes in India against them. The Bank Rate remained unchanged at 3 per cent. throughout.

Thus, currency has been expanded to the tune of 21 crores on the initiative of scheduled banks and 37 crores on the initiative of the Reserve Bank, making up a grand total of 58 crores. The expansion has taken the form of a rise in note circulation of 50 crores and a fall in the rupees and coins of the Issue Department of about 8 crores.

TABLE XXXV

	Average number of depositors per Banks	Total number of Depositors (000s)	Number of head branch.	Number of Sub branch.	Average Balance in each account.	Average Balance per Depositor.	Closing Balance (lakhs).	Postal Cash certificates (lakhs).	Government securities held in custody (Lakhs)
1890	...	...	...	...	...	...	635	...	...
1900	...	816	...	...	...	123	1004	...	...
1910	...	1430	...	...	...	118	1692	...	...
1911	...	1501	...	...	...	126	1890	...	...
1920-21	...	1877	...	...	...	121	2286	436	459
1925-26	...	2317	...	...	...	117	...	...	492
1926-27	209.9	...	255	11709	24603	117	2950	...	...
1927-28	211	2706	256	12070	26502	125	3266	...	...
1928-29	162.6	...	256	12166	27605	170	3449	...	...
1929-30	130.5	...	256	12512	29081	161	3718	...	...
1930-31	192.3	2477	256	12590	28822	149	3702	3800	578
1935-36	...	3541	...	...	...	...	...	...	...
1936-37	...	...	...	...	...	...	...	6440	...
1937-38	299.3	...	230	12401	61350	204	7749	...	...
1938-39	350.9	4241	230	11879	67602	193	8186	...	1077

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